1960

Uniform certified public accountant examinations, May 1957 to November 1959; Uniform CPA examination questions, May 1957 to November 1959

American Institute of Certified Public Accountants. Board of Examiners

UNIFORM CPA EXAMINATION QUESTIONS

MAY 1957 TO NOVEMBER 1959

UNIFORM CPA EXAMINATION · QUESTIONS · 1957—1959

UNIFORM
CERTIFIED PUBLIC ACCOUNTANT
EXAMINATIONS

Prepared by the board of examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands.

MAY 1957 to NOVEMBER 1959

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
270 Madison Avenue, New York 16, N. Y.

FOREWORD

This volume, the eleventh of its kind, includes the text of the Uniform Certified Public Accountant Examinations, prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands. The examinations from May 1957 to November 1959, inclusive, are included in this volume. The ten prior volumes contain all the examinations since 1917.

While the American Institute of Certified Public Accountants does not publish official answers, it is felt that students may be benefited by a review of the unofficial answers published from time to time in THE JOURNAL OF ACCOUNTANCY. Consequently, we are publishing simultaneously with this volume, a companion book entitled *Unofficial Answers to the Uniform CPA Examinations, May 1957 to November 1959,* which contains answers to the questions included in this volume.

JOHN L. CAREY, *Executive Director*
American Institute of Certified Public Accountants

March 1960

Contents

Complete Examinations

	Page		Page
May, 1957	1	November, 1958	78
November, 1957	25	May, 1959	108
May, 1958	52	November, 1959	146

Individual Subjects

Accounting Practice—Part I

May, 1957	1	November, 1958	78
November, 1957	25	May, 1959	108
May, 1958	52	November, 1959	146

Accounting Practice—Part II

May, 1957	7	November, 1958	85
November, 1957	32	May, 1959	116
May, 1958	58	November, 1959	154

Auditing

May, 1957	12	November, 1958	93
November, 1957	39	May, 1959	128
May, 1958	66	November, 1959	161

Commercial Law

May, 1957	16	November, 1958	97
November, 1957	43	May, 1959	136
May, 1958	70	November, 1959	166

Theory of Accounts

May, 1957	20	November, 1958	102
November, 1957	47	May, 1959	142
May, 1958	74	November, 1959	172

Index 177

Examination, May, 1957

EXAMINATION IN ACCOUNTING PRACTICE—PART I

May 15, 1957; 1:30 to 6:00 p.m.

GROUP I

(Required)

Number 1 (Estimated time—25 to 35 minutes)

The following 50 items relate to Federal Income Taxes. You are to assume in each case that the taxpayer files the long form 1040 return and that he itemizes his deductions. Also assume in each case where it is pertinent that he is an employee and that he has no Section 1231 gains. The items are not related to one another, but each is to be considered independently.

On the answer sheet provided, you are to enter an "X" in the proper column for each of the 50 items based on your decision as to whether the item is *Not Deductible*, *Deductible in Determining Adjusted Gross Income*, or *Deductible from Adjusted Gross Income.*

1. Depreciation of reference books by a teacher.
2. Payment of repair bill of $49.00 for damage to pleasure automobile from skid on icy road. (Not compensated for by insurance. Repair bill is a fair measure of the loss incurred.)
3. Fee paid employment agency for obtaining employment.
4. Labor union dues.
5. Loss of $200 on sale of Sigma Mining Corporation stock to son.
6. Fair market value of stamp collection (a hobby) stolen from home. Fair market value is less than cost.
7. Contribution to "Empty Stocking Fund" raised by neighbors for children of a needy family.
8. Purchase of Christmas seals (stamps) from Tuberculosis League.
9. Traveling expenses (overnight) of teacher attending scientific convention. Not reimbursed.
10. Bad debt of $50 on personal loan to a friend.
11. State income tax on individuals.
12. Federal cigarette tax.
13. State gasoline tax for pleasure car.
14. Depreciation on apartment building owned as an investment.
15. State fishing license.
16. Damage to lawn due to the usual August dry spell.

17. Loss of many of evergreens surrounding residence due to prolonged unexpected and unusual severe drought in September, October, and November.
18. Interest of $100 paid on loan on life insurance. Loan was used to finance purchase of income-producing securities.
19. Fee paid to take the CPA examination.
20. Safe deposit box rental, $7.20, for personal income-producing securities.
21. Safe deposit box fee, $6.00, for personal jewelry.
22. Federal tax, $1.20, on safe deposit box in item 21.
23. Fee to Smith & Brown, firm of investment consultants, for advice on personal portfolio of securities.
24. Cost of spiked shoes bought by professional baseball player.
25. Dues to American Institute of Certified Public Accountants paid by a member of staff of Jones & Co., CPA's.
26. Ring lost from owner's finger while swimming.
27. Loss on sale of personal automobile.
28. Entertaining customers, by employee (not an outside salesman), not reimbursed. Entertaining is required; also ordinary and necessary.
29. Cost of cleaning uniform paid by train conductor.
30. Loss of $10 playing "Spin-the-Wheel" at a fair sponsored by Volunteer Fire Company.
31. Amortized bond premium for the year on New York State Bonds.
32. Cost of tools (life less than one year) necessary for employee's job; not reimbursed.
33. Cleaning and laundry expenses while traveling away from home.
34. Fair market value of furniture given to the Salvation Army.
35. Damage to personal residence by bursting of pipes resulting from an unusually severe freeze.
36. Medical expenses paid in 1956, incurred in 1955. (Answer with regard to deductibility in 1956 tax return.)
37. $1.00 for 16-year-old daughter's driver license. She is dependent of father taxpayer.
38. State stamp taxes on securities sold by investor.
39. Attorney's fee for searching title to residence purchased.
40. Fair market value ($20) of one pint of blood donated to Memorial Hospital.
41. Periodic alimony payment made pursuant to divorce decree (which ex-wife included in gross income).
42. Premium amortized on non-convertible corporate bonds.
43. $10 cost (also fair market value) of cakes donated to church for a bake sale.
44. Entertainment expenses required of an outside salesman; not reimbursed.
45. Attorney's fee for obtaining divorce.
46. Car-pool expenses for driving to and from work in excess of amounts received from passengers.
47. Traveling costs (overnight) in search of employment.
48. Cost of refresher course taken at evening school (not required by his employer).
49. Interest for the year on mortgage held by taxpayer's brother. Interest and mortgage were paid on December 31.
50. Cost of repairs to neighbor's automobile which you side-swiped when pulling into your driveway; no insurance.

GROUP II

(Estimated time—80 to 120 minutes)

Solve any two problems in this group. If more are solved, only the first two will be considered.

Number 2

F. Leftgal is a plumbing contractor operating as a sole proprietorship.

It is the regular practice of the business at the time a contract is received to set up the full contract price by a charge to Accounts receivable and a credit to Unearned contract sales. As work progresses on an individual contract, progress billings are sent to customers. No entry is made on the books for such progress billings. Collections are entered as a credit to Accounts receivable. Income is recognized on a completed contract basis for statement purposes.

No charge is made to Work-in-process for general overhead expenses until a contract is completed and closed out to completed contracts. At that time 10% is added to direct costs an an allocation of general expenses. There are no inventories of materials since they are purchased only as needed for contracts.

The following balances are shown by the books as of December 31, 1956:

	Debit	*Credit*
Cash	$ 5,200	
Accounts receivable	125,500	
Work-in-process	118,250	
Fixed assets (net)	21,000	
Accounts payable		$ 5,100
Unearned contracts		144,000
Leftgal, capital		67,850
Contract sales		400,000
Cost of sales	308,000	
Expenses	67,000	
Expenses absorbed		28,000
	$644,950	$644,950

The following schedule of accounts receivable and work-in-process has been prepared by the bookkeeper.

	Accounts Receivable	*Direct Costs*	*Contract Price*	*Amount Billed*
Easy Co.	$ 46,500	Closed		
Louis Building Co.	—	$ 7,500	$ 9,000	$ 9,000*
Joseph & Sons, Inc.	1,000	17,500	15,000	15,000*
Goss Wreckers	2,000	8,250	14,000	13,000
Bealey Co.	11,000	35,000	41,000	30,000
Davis Co.	65,000	50,000	65,000	30,000
	$125,500	$118,250	$144,000	$97,000

* *Completed contracts not closed on books.*

You are to prepare a formal balance sheet as of December 31, 1956 and an income statement for the year. Support all items requiring adjustments with appropriate schedules or computations in good form.

Number 3

A client has recently leased manufacturing facilities for production of a new product. Based on studies made by his staff, the following data have been made available to you:

Estimated annual sales	24,000 units	
Estimated costs:	*Amount*	*Per Unit*
Material	$ 96,000	$4.00
Direct labor	14,400	.60
Overhead	24,000	1.00
Administrative expense	28,800	1.20
Total	$163,200	$6.80

Selling expenses are expected to be 15% of sales and profit is to amount to $1.02 per unit.

a. Compute the selling price per unit.

b. Project a profit and loss statement for the year.

c. Compute a breakeven point expressed in dollars and in units assuming that overhead and administrative expenses are fixed but that other costs are fully variable.

Number 4

On January 1, 1956 Medium City established a working capital fund for operating a central motor vehicle pool. It transferred $100,000 from the general fund.

Immediately upon establishment, a fleet of trucks was purchased as follows:

Type	*Number*	*Cost per Truck*
4-ton GMC	4	$3,500
3-ton Ford	4	2,500
3-ton Mack	4	2,200
1-ton Dodge	5	1,500

Operating each of the three- and four-ton trucks requires a driver and a helper who are paid standard wage rates of $2.00 and $1.50 per hour, respectively. The one-ton trucks do not require a helper.

All trucks are depreciated on a straight-line basis over a 5-year period with 5% residual salvage value.

Trucks are rented to the general fund on an hourly basis and the following usage and gasoline costs were reported for the year ended December 31, 1956:

Type	*Rental Rate per Hour*	*Total Number of Hours Used*	*Cost of Gasoline Used*
4-ton GMC	$5.50	6,000	$2,400
3-ton Ford	5.00	8,000	2,400
3-ton Mack	5.00	8,000	2,800
1-ton Dodge	3.00	15,000	3,000

The following additional costs were incurred in operation of the fleet:

(1) Drivers' and helpers' wages were paid for exactly the hours the trucks were used. There was no unpaid payroll at the end of the year.

(2) Unpaid gasoline invoices at December 31, 1956 aggregated $1,500.

(3) Other indirect costs incurred were as follows:

Supervision	$15,000
Repairs	10,000
Tires and tubes purchased	1,600

There were no unpaid bills at December 31, 1956 pertaining to the above items; however, at the end of the year the fund had on hand an inventory of new tires costing $500.

During the year the general fund paid the vehicle pool $95,000 on its account for services rendered.

a. You are to prepare the journal entries to open the fund, to record the transactions in it for 1956, and to close the fund at December 31st.

b. Prepare a balance sheet in good form for the fund as of December 31, 1956. (A worksheet is not acceptable in meeting this requirement. It is suggested that the statement be prepared from the entries and the use of skeleton "T" accounts.)

GROUP III

(Estimated time—70 to 115 minutes)

Solve either problem in this group. If both are solved, only Number 5 will be considered.

Number 5

a. On the worksheet enclosed, the balance sheets and statements of income for the year ended December 31, 1956 of the X Company and its wholly owned subsidiary, the Y Company, are given in columnar form. Additional information about the companies is given below.

Complete the worksheet, making the necessary eliminating and adjusting entries, and extend the consolidated figures for the statement purposes. Key the debit and credit side of each entry.

b. Prepare a schedule showing the changes for 1956 in retained earnings of the companies and the entries necessary for consolidation.

ADDITIONAL INFORMATION:

(1) Marketable securities of the subsidiary includes $20,000 cost of shares of the parent company's stock acquired for payment of bonuses.

(2) There is merchandise billed at $10,000 in transit from the parent to the subsidiary which has not been recorded by the subsidiary.

(3) It has been determined that there is intercompany profit of $20,000 in the

portion of the subsidiary's inventory purchased from the parent. The equivalent figure at December 31, 1955 was $10,000.

(4) The parent's equity in the subsidiary was $200,000 at the date of acquisition.

(5) Sales by the parent to the subsidiary in 1956 totaled $1,700,000.

(6) The parent has made a service charge of $50,000 to the subsidiary which is included in Other income of the parent and in Administrative expenses of the subsidiary.

Number 6

The Johnson Company began operations on January 1, 1956. It manufactures a single product. The company installed a standard cost system, but will adjust all inventories to actual cost for financial statement purposes at the end of the year.

Under its cost system, raw material inventory is maintained at actual cost. Charges made to work-in-process are all made at standard prices. Variance accounts are used into which all variances are entered as they are identified.

One-half of the cost of raw material for each unit is put into production at the beginning of the process and the balance when the processing is about one-third completed.

Standard cost was based on 256,000 direct labor hours with a production of 1,600 units. The standard was as follows:

Materials (100 lbs. @ $2.00)	$200
Direct labor (160 hrs. @ $1.25)	200
Manufacturing expense (based on direct labor hours) (160 @ $0.25)	40
Total standard cost per unit	$440

A summary of the transactions for the year ended December 31, 1956 shows the following:

Material purchased (180,000 lbs. @ $2.20)	$396,000.00
Direct labor (247,925 hrs. @ $1.30)	322,302.50
Manufacturing overhead	49,585.00
Material issued to production	177,600 lbs.
Units processed:	
Units completed	1,500
Units one-half complete	150
Units one-fourth complete	30

a. Using the form provided, record the transactions in the manufacturing accounts only for the year. In each account, give an indication of the nature of each item recorded. Do not use any additional accounts.

b. Using the skeleton ledger accounts in which costs were recorded, make the entries needed to adjust Finished goods to actual cost for material. Give identifiable supporting computations showing clearly the method of arriving at each adjustment. You need not adjust for labor or manufacturing expense.

c. Prepare a statement showing details of the material cost included in work-in-process inventory as adjusted to actual cost.

EXAMINATION IN ACCOUNTING PRACTICE—PART II

May 16, 1957; 1:30 to 6 p.m.

(Solve all problems)

Number 1 (Estimated time—30 to 50 minutes)

The Prosperous Co. issued $1,000,000 of Convertible 10-year Debentures on July 1, 1955. The debentures provide for 4% interest payable semi-annually on January 1 and July 1. Expense and discount in connection with the issue was $19,500 which is being amortized monthly on a straight-line basis.

The debentures are convertible after one year into 7 shares of the Prosperous Co.'s $100 par value common stock for each $1,000 of debentures.

On August 1, 1956, $100,000 of debentures were turned in for conversion into common. Interest has been accrued monthly and paid as due. At the time of conversion any accrued interest on debentures being converted is paid in cash.

You are to prepare the journal entries to record the conversion, amortization and interest in connection with the debentures as of:

a. August 1, 1956.

b. August 31, 1956.

c. December 31, 1956—including closing entries for end of year.

Support your entries with computations in good form.

Number 2 (Estimated time—35 to 50 minutes)

Company P, a manufacturer of earth-moving equipment, sells 10 units at its regular selling price of $18,000 each (cost is $12,000 each) to its wholly-owned subsidiary, Company S, on September 1, 1956. Company S is an unconsolidated subsidiary, carried on Company P's books as an investment at a value adjusted for Company S earnings.

Both Company P and Company S are on the accrual basis and use a calendar year accounting period.

Company S was incorporated on July 1, 1956, and its capital stock of $25,000 was sold to P at par. It paid for the equipment purchased from Company P by obtaining a 4-year, 6% bank loan on September 1, 1956 for the entire purchase price. The units purchased were leased to Company O, a non-affiliated company, and the lease was assigned as collateral for the bank loan. The loan is payable in equal monthly principal installments on the first of each month plus interest for the preceding month, starting October 1, 1956. (Interest is computed on a 30-day month, 360-day year basis.)

Company S depreciates the equipment on the basis of actual hours used, using a 12,000-hour operating life per unit.

The lease agreement with Company O is dated September 1, 1956 and runs for 4 years. It provides for rental payments starting October 1, 1956 based on the actual number of hours used the preceding calendar month. Rent is to be computed at the rate of $1.80 per hour, with a minimum monthly rental of $2,500, and a maximum total rental of $216,000. Hours operated were: September, 4,000; October, 5,000; November, 5,500; December, 3,500.

Do not consider Federal income taxes in connection with this problem.

a. What is the amount of gross profit that Company P should report on its income statement for 1956 as realized from the sale? State your reasoning.

b. Assuming that this is Company S's only business activity, what is its net income for 1956? (Give your supporting computations in good form.)

c. What is the carrying value of Company S on Company P's books at December 31, 1956?

Number 3 (Estimated time—35 to 50 minutes)

X, Y and Z are partners sharing profits in the ratio of 4, 3, and 2 respectively. The partnership and two of the partners are currently unable to pay their creditors. The firm balance sheet and personal status of the partners are as follows:

X, Y AND Z PARTNERSHIP

Balance Sheet

ASSETS		LIABILITIES	
Cash	$ 500	Accounts and bills payable	$37,000
Other assets	60,500	Capital: X	10,000
		Y	6,000
		Z	8,000
	$61,000		$61,000

PERSONAL STATUS OF PARTNERS

(Excluding partnership interests)

Partner	*Cash and Cash Value of Personal Assets*	*Liabilities*
X	$31,000	$20,000
Y	9,450	11,900
Z	4,000	5,000

a. Prepare a worksheet showing distributions to partnership and personal creditors in the event of dissolution under the provisions of the *Uniform Partnership Act,* assuming that the "Other assets" are sold for $33,500.

b. Prepare a computation showing the minimum amount which must be realized from the sale of the partnership assets other than cash, so that the personal creditors of Y would receive full settlement of their claims.

Number 4 (Estimated time—80 to 120 minutes)

Mr. Flowers, who is operating a small manufacturing business, did not keep adequate records during 1956 to determine his taxable income or prepare an acceptable balance sheet. He has furnished you with the following schedules of his assets and liabilities at December 31, 1955 and December 31, 1956 and has asked you to determine his taxable business income for the year and to make adjustments needed for a balance sheet as of December 31, 1956.

INVENTORY OF ASSETS AND LIABILITIES

	December 31, 1955	*December 31, 1956*
Cash	$ 5,000	$ 3,100
Accounts receivable	22,100	17,600
Notes receivable	6,000	8,500
Inventories—Raw materials	6,000	10,000
Inventories—Manufactured products	22,000	24,000
Fixed assets	105,000	112,000
Allowance for depreciation	(77,000)	(83,500)
Investments	36,700	24,900
	$125,800	$116,600
Accounts payable	$ 21,000	$ 14,500
Notes payable	—	10,000
Flowers, capital	104,800	92,100
	$125,800	$116,600

From inquiry and examination of available records you determine the following additional information:

1. The cash figures given are the amounts appearing as the balances on his bank statement at each of the balance sheet dates. By reviewing subsequent bank statements and cancelled checks you find the following:
   (a) A deposit of $1,000 made on December 31, 1955 was not recorded by the bank until January 3, 1956. Four checks totaling $900 dated prior to December 31, 1955 were returned by the bank in January, 1956.
   (b) A deposit was entered by the bank on December 31, 1956 in the amount of $4,000 which was a collection from Jones & Jones on a sight draft. Mr. Flowers did not receive notice of the collection until January 5, 1957.
   (c) Outstanding checks at December 31, 1956 were found to total $450.
2. The following is a trial balance of accounts receivable at December 31, 1956:

Accounts Receivable

Ace Sales Co.	$ 6,000
Ajax Construction Co.	3,000
Jones & Jones	4,000
Williamson & Sons	2,500
Blue Mt. Construction Co.	2,100
	$17,600

An account receivable from M.B.A. Construction Co. totaling $4,500 has not been included in accounts receivable because full collection was doubtful. Prior to the time you start work you find that $3,700 of this receivable was collected in full settlement of the account.

3. Notes receivable are from customers and are considered collectible.
4. The inventories of manufactured products are stated at sales price at the inventory date. The average margin on sales was 40 per cent at December 31, 1955 and 39.5 per cent at December 31, 1956. Raw materials are stated at cost.
5. The receivable from Ace Sales Co. contains $2,000 of merchandise shipped on consignment on December 26, 1956 and billed at regular sales price.
6. In reviewing fixed assets it was found that in 1956 a machine purchased in 1935 at a cost of $4,000 was sold for $2,000 and the proceeds credited to the asset account. It was also determined that depreciation rates in prior years were not consistently applied each year. The asset acquisitions are set forth in the following schedule with proper depreciation rates. Depreciation for one-half year is recorded in year of acquisition and disposition and no consideration is given to salvage value.

December 31, 1955:	*Year Acquired*	*Cost*	*Depreciation Rate*
Machinery and equipment	1935	$ 20,000	5%
	1939	16,000	5%
	1940	69,000	5%
Total 12/31/55		$105,000	
Purchased in 1956:			
Machinery		$ 9,000	6 2/3%

In addition to the sale mentioned above it is found that a machine purchased in 1939 for $6,000 was traded in on the machine purchased in 1956. An allowance of $3,000 for the old machine was received on the new machine which listed for $12,000.

7. In reviewing stock transactions you find the following stock was owned at December 31, 1955 and December 31, 1956:

Stock	*Shares*	*Par Value*	*December 31, 1955*	*December 31, 1956*
ABC Company	100	$100	$10,000	$10,000
Columbia Mfg. Co.	200	50	10,000	
New York Exporting Co.	167	100	16,700	
Jones & Jones Company ..	149	100		14,900
			$36,700	$24,900

(a) Fifty shares of ABC Company stock was acquired at par value in 1950. In 1952 a 100 per cent stock dividend was received.

(b) The Columbia Mfg. Co. stock was purchased for $11,000 in 1952 and was sold for $9,500 in 1956.

(c) The New York Exporting Co. stock was purchased for $17,000 in January, 1953 and sold in 1956 for $20,000.

(d) The Jones & Jones Company stock was purchased in October, 1956 for $22,500.

8. An account payable to Steel Supply Co. in the amount of $1,800 has been carried in accounts payable since June, 1955. This was found to have been

paid in November of 1955. An account payable to Peter Steel Fabricating Co. for $900 was included in the December 31, 1956 trial balance of accounts payable. The material covered by this invoice was not received until January 25, 1957 and was not included in the inventory at December 31, 1956.

9. The note payable covers a loan which was obtained for purchase of a home for the proprietor's daughter who was married in 1956.
10. The following expenditures other than those commented on were made during the year 1956:
    (a) Payments on 1955 income tax—$3,100.
    (b) Payments on 1956 estimated tax—$6,000.
    (c) An automobile costing $3,000 was purchased for Mrs. Flowers and charged to delivery expense on the books.
    (d) Household and other personal expenditures amounted to $14,900 for the year and were all paid out of a separate bank account into which withdrawals from the business had been deposited in this amount.

Required:

a. Prepare a worksheet adjusting the balance sheet accounts as of December 31, 1955.

b. Prepare a worksheet adjusting the balance sheet accounts as of December 31, 1956.

Note: *In a. and b. you should key the debit and credit parts of each adjusting entry. Support major adjustments (such as for Allowance for depreciation) with a schedule in good form. You need not prepare formal journal entries.*

c. Prepare a schedule showing the determination of the amount of Mr. Flowers' taxable business income for 1956. Show details of any changes required to place items on the tax basis.

EXAMINATION IN AUDITING

May 16, 1957; 9 a.m. to 12:30 p.m.

GROUP I

(Estimated time—90 to 120 minutes)

(Answer any five questions in this group. If more are answered, only the first five will be considered.)

Number 1

In connection with your audit of the ABC Co. at December 31, 1956 you were given a bank reconciliation by a company employee which shows:

Balance per bank	$15,267
Deposits in transit	18,928
	$34,195
Checks outstanding	21,378
Balance per books	$12,817

As part of your verification you obtain the bank statement and cancelled checks from the bank on January 15, 1957. Checks issued from January 1 to January 15, 1957 per the books were $11,241. Checks returned by the bank on January 15th amounted to $29,219. Of the checks outstanding December 31st, $4,800 were not returned by the bank with the January 15th statement, and of those issued per the books in January 1957, $3,600 were not returned.

a. Prepare a schedule showing the above data in proper form.

b. Suggest four possible explanations for the condition existing here and state what your action would be in each case, including any necessary journal entry.

Number 2

State five of the principal uses of audit working papers.

Number 3

In an annual audit at December 31, 1956 you find the following transactions near the closing date.

(1) Merchandise costing $1,822 was received on January 3, 1957 and the related purchase invoice recorded January 5. The invoice showed the shipment was made on December 29, 1956, *F.O.B. destination.*

(2) Merchandise costing $625 was received on December 28, 1956 and the invoice was not recorded. You located it in the hands of the purchasing agent; it was marked *on consignment.*

(3) A packing case containing product costing $816 was standing in the shipping room when the physical inventory was taken. It was not included in the inventory because it was marked *Hold for shipping instructions.* Your investigation revealed that the customer's order was dated Dec. 18, 1956

but that the case was shipped and the customer billed on January 10, 1957. The product was a stock item of your client.

(4) Merchandise received on January 6, 1957 costing $720 was entered in the purchase register on January 7, 1957. The invoice showed equipment was made F.O.B. supplier's warehouse on December 31, 1956. Since it was not on hand at December 31, it was not included in inventory.

(5) A special machine, fabricated to order for a customer, was finished and in the shipping room on December 31, 1956. The customer was billed on that date and the machine excluded from inventory although it was shipped on January 4, 1957.

Assume that each of the amounts is material.

a. State whether the merchandise should be included in the client's inventory.

b. Give your reason for your decision on each item in (a) above.

Number 4

A new junior on the staff asks you why it is necessary to make any audit of petty cash when both the size of the fund and the total petty cash expenditures for the audit period appear to be immaterial.

How would you answer the junior's question? Give the reasons for your answer.

Number 5

Recent proposals would have auditors apply the principles of statistical sampling to auditing. Assuming that the claims made for the principles of statistical sampling as applied to auditing are valid, state the weaknesses of traditional auditing procedures which would be corrected and the improvements in auditing which would result from the application of such principles.

Number 6

Your client has entered into an agreement to acquire the machinery and equipment and inventories of another company as of November 30th. The agreement provides that the machinery and equipment will be purchased at a fixed price. The price for the inventories, determined by physical count, will be at the lowest of (1) actual, (2) market, or (3) standard costs. The seller does not maintain a plant ledger, but does keep perpetual records of inventories of raw materials and supplies. Sales and inventories have been priced at standard costs. You will be expected to make an audit as of December 31st.

a. Your client has asked you to advise his chief accountant on the procedures he should follow as to machinery and equipment and as to inventories in order to record properly the items in the books and make them susceptible to audit. State the advice you would give.

b. State the general auditing procedures you would follow as to these acquisitions on November 30th and December 31st. You are not to prepare a detailed audit program.

Number 7

One of your clients is planning to make a loan to a company which is engaged in developing a mining property. Your client wants advice as to the financial information he should obtain before making the loan. He has obtained an engineering report and the prospective borrower has submitted the following balance sheet.

Fixed assets	$50,000	Liabilities	$12,500
		Capital	37,500
	$50,000		$50,000

a. What information would you expect to obtain from the engineer's report that would be of particular interest in evaluating the merits of the loan?

b. What additional information would you expect the prospective borrower to furnish?

GROUP II

(Answer both questions in this group.)

Number 8 (Estimated time—30 to 45 minutes)

In connection with a general audit of a manufacturing company, it is necessary to make an examination of miscellaneous cash receipts, as distinguished from general receipts.

State specifically the procedures an auditor should follow to satisfy himself that all cash from the following sources has been received that should have been received.

(1) Interest and dividends on securities owned, and interest on notes receivable.
(2) Amounts received for equipment sold, exchanged, etc.
(3) Proceeds from bank loans.
(4) Refunds of advances for travel expenses.
(5) Refunds of insurance premiums.
(6) Rentals from property owned.
(7) Royalties received.
(8) Sales of scrap.
(9) Sales of capital stock and bond issues.
(10) Sales of securities owned.

Number 9 (Estimated time—30 to 45 minutes)

The Jones Manufacturing Company was incorporated and began business on January 1, 1953. It has been successful and now requires a bank loan for additional working capital to finance expansion. The bank has requested an audited statement for the year ended December 31, 1956. The company has not had an audit made in prior years. You have been retained to examine the financial statements.

The following is the condensed balance sheet as of November 30, 1956:

Cash	$ 20,000	Current liabilities	$200,000
Accounts receivable	30,000	Mortgage	300,000
Inventory	300,000	Capital stock:	
Plant machinery equipment	500,000	3,000 shares no par value	300,000
Other assets	50,000	Retained earnings	100,000
	$900,000		$900,000

Your examination disclosed the following facts:

(1) The company started a job cost system in 1956. Prior to that time no unit costs are available. The inventory includes 100 units of certain finished goods, manufactured prior to January 1, 1956, estimated to cost $50,000 and component parts for an additional 100 units estimated to cost $25,000 in labor, material and overhead. Sales during 1956 were 20 units at $850 each. Management informs you that they overestimated the market for these items but that eventually they will recover the cost by sale of the units. However, your investigation discloses that this particular unit has been superseded by a more efficient model and there is reason to question the optimism of management regarding the salability of the units on hand. The inventory value was estimated since no cost records were maintained. You made tests in an effort to establish the validity of the cost estimates, but were unable to do so. The balance of the inventory consists of items manufactured or acquired during 1956. Application of generally accepted auditing procedures established that this portion of the inventory is properly priced at the lower of cost or market on the first-in-first-out method.

(2) On June 26, 1956 the Board of Directors granted options to certain officers and employees for the purchase of 500 shares of unissued capital stock at $100 per share. The options may be exercised at any time prior to December 31, 1958. No stock has been issued under these options.

(3) The company entered into a 5-year lease for a warehouse, beginning July 1, 1956, calling for annual rentals of $12,000 payable monthly. The lease also provides for renewal for an additional 5 years at an annual rental of $15,000. The company pays insurance, taxes and maintenance on the property.

a. Do any of these matters require disclosure in the financial statements or qualification of the auditor's opinion? Give reasons for your conclusion in each case.

b. If disclosure or qualification is required, prepare a carefully worded note or qualifying statement for use in your audit report.

EXAMINATION IN COMMERCIAL LAW

May 17, 1957; 9 a.m. to 12:30 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—22 to 30 minutes)

a. Distinguish an *invitation to trade* from a valid *offer to contract.*

b. State three methods by which an offer may be revoked or terminated.

c. Define the term *promise* as it is used in contracts.

d. Where an offer is met with silence by the offeree, can such silence be construed as indicating acceptance? Explain.

e. State the circumstances which constitute exceptions to the parol-evidence rule that the terms of a written agreement cannot be attacked by proof of contradictory oral agreement.

f. What is *tortious interference with a contract?*

Number 2 (Estimated time—10 to 15 minutes)

Thaddeus Lucas and Paul Menter entered into a written agreement whereby Lucas was to manufacture 500 dresses of certain styles and sizes at stipulated prices for each style. Under the terms of the contract, Menter was to pay for same upon delivery and Lucas was to deliver the goods to Menter. Both parties considered that their agreement constituted an actual sale as of the time of its making.

a. Is this correct? If not, state the exact effect of the agreement. Explain.

b. When does title to the goods pass? Explain.

Number 3 (Estimated time—18 to 25 minutes)

a. Define a partner by estoppel.

b. In the absence of special agreement, where must partnership books of account be kept?

c. Distinguish between voluntary and involuntary dissolution of a partnership.

d. Where on dissolution the adjustment of accounts as among the partners is not governed by special agreement, state what rules govern.

e. State the meaning of the term *marshaling assets.*

Number 4 (Estimated time—15 to 20 minutes)

a. State fully the nature of the CPA's legal responsibility to clients as to skill and care in performing an engagement.

b. Explain why there is a special duty imposed by law upon professional men in performing their services.

c. Discuss briefly the accountant's legal responsibility as to communicating the results of his work to his client.

GROUP II

(Estimated time—85 to 120 minutes)

(Answer any five questions in this group. If more are answered, only the first five will be considered.)

Number 5

a. Andrew Elder insures his life for $10,000 and names his friend William Spencer as beneficiary. Spencer is in no way related to Elder. Upon Elder's death the policy is in force, premiums are fully paid, and Spencer is still the beneficiary. Can Spencer collect the proceeds of the policy? Explain.

b. Philander Turner insures his life for $10,000 and names his wife Eliza as unconditional beneficiary. Both Philander and Eliza become insolvent and are heavily in debt. Philander continues to pay the premiums and makes no change of beneficiary. Philander then dies.
   (1) Can Philander's creditors reach the proceeds of the policy, and, if so, to what extent? Explain.
   (2) Can Eliza's creditors reach the proceeds of the policy, and, if so, to what extent? Explain.

Number 6

a. Bradner and Rafferty, an accounting firm with a local practice in New York City, acquired the practice and goodwill of Chester and Blackburn, another accounting firm which had a well-established local practice in Albany, New York, one hundred and twenty-five miles away. The written agreement under which the Albany practice was acquired contained a non-competition clause providing that Chester and Blackburn, both individually and as members of any accounting firm, were not to engage in practice anywhere in the United States east of the Mississippi River for a period of five years.
   (1) Outline generally the principles of law applicable.
   (2) Discuss application of the principles to the non-competition clause in the above agreement.

b. Reisner and Brandon, an accounting firm operating nationally over a long period of years with branch offices in all major cities covering all major industrial areas in the country, acquired the entire practice and goodwill of Baxter and Mannix, another accounting firm operating nationally and with branch offices in all major cities. The price was to be paid in annual installments over a period of ten years. The written agreement under which the Baxter and Mannix practice was acquired contained a non-competition clause providing that the five major partners of that firm, both individually and as members of any accounting firm, were not to engage in practice anywhere in the United States for a period of ten years.

Outline generally the principles of law applicable and their application to the non-competition clause in the above agreement.

Number 7

Kenneth Spencer executed his promissory note in the sum of $300 payable to the order of Henry Pape, with interest at the rate of 4%. The note was dated August 1, 1955 and payable ninety days after date. After its receipt by Pape the latter negotiated it by special indorsement to Frederick Stoddard. Stoddard thereupon, without the knowledge or consent of Spencer or Pape, made the following alterations in the note. He changed the rate of interest to 5%, crossed out the provision "payable ninety days after date," inserted in its place the words "payable October 30, 1955," and then added words to the note making it payable at a specified place. He then negotiated it by special indorsement to Henry Adams, a holder in due course and not a party to the alterations.

a. State as to each alteration, whether it is a material or immaterial alteration. Give your reasons.
b. Assuming that one or more of the alterations are material, what is the effect of such material alteration as to liability of Spencer, Pape and Stoddard upon the instrument in its altered form? Why?
c. Assuming that one or more of the alterations are material, what right, if any, has Adams against Spencer? Explain.

Number 8

Allen owed Brown $10,000, and Brown owed $5,000 to Charles, $8,000 to Drum, and $50,000 to other creditors. On March 16, 1957, a petition for Brown's involuntary bankruptcy was filed. On April 3 Brown was adjudged insolvent and a bankrupt, under the Federal Bankruptcy Act. Subsequently a trustee in bankruptcy was appointed.

What would be the effect of:

a. Brown's payment of his unsecured debt to Drum on March 10, 1957, when Brown was insolvent.
b. Allen's payment of the $10,000 debt to Brown on March 20, 1957, in good faith, Allen being ignorant of the fact that the petition had been filed.
c. Allen's purchase of Charles' $5,000 claim against Brown on March 25, 1957, with knowledge of Brown's insolvency and that the petition had been filed, and with intent to set off the $5,000 claim against Brown's claim for $10,000 against Allen.

Number 9

a. B contracted to buy twenty new typewriters from S. Before the typewriters had been appropriated to the contract and before the title had passed to B, without cause he notified S that he would not accept the typewriters or pay for them. S sued B for the purchase price. B contended that he was only liable for damages. Who is correct? Why?

b. B purchased by description twenty bushels of sweet potatoes from S, a dealer in fruits and vegetables. After they were delivered, B discovered that they had been frozen and were unfit either for consumption or resale. Can B recover damages from S? Explain.

c. B inspected 300 bushels of wheat in a bin and agreed to buy 100 bushels out of the bin from S. It was agreed that B would haul the wheat away a week later and pay the purchase price within two months. Two days after the agreement was made the entire lot of wheat was destroyed without any fault on S's part. B refused to pay the purchase price. S filed suit for the purchase price. B contended that the title to the wheat had not passed to him so that the risk of loss was on S. Who is correct? Why?

Number 10

The following terms or concepts are used in the law of negotiable instruments. Define, distinguish, explain or illustrate the following terms:

a. (1) Assignment
   (2) Negotiation

b. (1) Restrictive Indorsement
   (2) Special Indorsement

c. (1) *Real* Defense
   (2) *Personal* Defense

d. (1) Bill of Exchange
   (2) Bond

Number 11

a. State the nature and extent of the liability of a common carrier for:
   (1) Damage to goods carried for hire
   (2) Injury to passengers carried for hire
   What are the reasons for the similarity or differences in the liabilities?

b. At what point does the liability of a common carrier of goods begin, and at what point does it end? Explain.

EXAMINATION IN THEORY OF ACCOUNTS

May 17, 1957; 1:30 to 5:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—25 to 35 minutes)

The DEF Manufacturing Company has followed the practice of valuing their temporary investments in marketable securities at the lower of cost or market. At December 31, 1956 their account *Investment in marketable securities* had a balance of $40,000, and the account *Allowance to reduce investments from cost to market* had a balance of $2,000. Analysis disclosed that on December 31, 1955, the facts relating to the securities were as follows:

Security	*Cost*	*Market*	*Allowance Required*
X Company Bonds	$20,000	$19,000	$1,000
Y Company Bonds	10,000	9,000	1,000
Z Company Bonds	20,000	20,300	0
	$50,000		$2,000

During 1956 the Y Company Bonds were sold for $9,200, the difference between the $9,200 and the cost of $10,000 being charged to "Loss on Sale of Securities." The market price of the bonds on December 31, 1956 was: X Company Bonds—$19,200; Z Company Bonds—$20,400.

a. What justification is there for the use of the lower of cost or market in valuing marketable securities?

b. Did the DEF Company properly apply this rule on December 31, 1955? Explain, including any alternative methods of application.

c. Are there any additional entries necessary for the DEF Company at December 31, 1956, to reflect the facts on the balance sheet and income statement in accordance with generally accepted accounting principles? Explain.

Number 2 (Estimated time—12 to 20 minutes)

INSTRUCTIONS: You are to match each of the ten numbered items with the one term listed below (A through R) which most specifically identifies the cost concept indicated parenthetically.

(Caution: An item of cost may be classified in several ways, depending on the purpose of the classification. For example, the commissions on sales of a proposed new product line might be classified as *direct, variable,* and *marginal,* among others. However, if such costs are being considered specifically as to the amount of cash outlay required in making a decision concerning adoption of the new line, the commissions are *out-of-pocket costs.* That would be the most appropriate answer in the context.)

On your answer sheet list the numbers 1 through 10. Indicate your choice of answer for each item by printing beside the item numbers the capital letter which identifies the term you select.

Term	*Term*	*Term*
A. By-product costs	G. Historical cost	M. Out-of-pocket costs
B. Common or joint costs	H. Imputed costs	N. Prime costs
C. Controllable costs	I. Differential cost	O. Replacement costs
D. Direct costs	J. Indirect costs	P. Standard costs
E. Estimated costs	K. Opportunity costs	Q. Sunk costs
F. Fixed costs	L. Original cost	R. Variable costs

ITEMS

1. The management of a corporation is considering replacing a machine which is operating satisfactorily with a more efficient new model. *Depreciation* on the cost of the existing machine is omitted from the data used in judging the proposal, because it has little or no significance with respect to such decision. (The omitted cost.)
2. In *public utility accounting,* regulatory bodies require that assets be carried at the cost to those owners who first devoted the assets to public use. (The cost described.)
3. One of the problems encountered by a bank in attempting to establish the cost of a *commercial-deposit* account is the fact that many facilities and services are shared by many revenue-producing activities. (Costs of the shared facilities and services.)
4. A company declined an offer received to rent one of its warehouses and elected to use the warehouse for storage of extra raw materials to insure uninterrupted production. Storage cost has been charged with the monthly amount of the rental offered. (This cost is known as?)
5. A manufacturing company excludes all "fixed" costs from its valuation of inventories, assigning to inventory only applicable portions of costs which vary with changes in volume of product. (The term employed for the *variable* costs in this context by advocates of this costing procedure.)
6. The sales department urges an increase in production of a product and, as part of the data presented in support of its proposal, indicates the total additional cost involved for the volume-level it proposes. (The increase in total cost.)
7. A CPA takes exception to his client's inclusion in the cost of a fixed asset of an "interest" charge based on the client's own funds invested in the asset. The client states the charge was intended to obtain a cost comparable to that which would have been the case if funds had been borrowed to finance the acquisition. (The term which describes such *interest* charges.)
8. The "direct" production cost of a unit includes those portions of factory

overhead, labor and materials which are obviously traceable directly to the unit. (The term used to specify the last two of the named components.)

9. Calling upon the special facilities of the production, planning, personnel and other departments, a firm estimated its future unit cost of production and used this cost (analyzed by cost elements) in its accounts. (The term used to specify this scientifically predetermined estimate.)
10. A chemical manufacturing company produces three products originating in a common initial material mix. Each product gains a separate identity part way through processing and requires additional processing after the "split." Each contributes a significant share of revenue. The company plans to spread the costs up to the "split" among the three products by the use of relative market values. (The term used to specify the costs accumulated up to the point of the *split.*)

Number 3 (Estimated time—13 to 20 minutes)

It has been suggested by some that plant and equipment would be replaced more quickly if depreciation rates for income tax and other accounting purposes were substantially increased. As a result, business operations would receive the benefit of more modern and more efficient plant facilities.

Discuss the merits of this proposition.

Number 4 (Estimated time—20 to 30 minutes)

On January 2, 1955, the ABC Company purchased display equipment for their store under the following terms: $2,000 to be paid upon installation, plus five annual payments of $1,000, the first payment to be made on December 31, 1955. Title to the display equipment was retained by the seller until the final payment was made. It is estimated that the display equipment will be used for ten years, with no residual value.

This same display equipment was available at a cash price of $6,600.

You are required to make all accounting entries relating to the display equipment as of January 2nd and December 31, 1955 and as of December 31, 1956. For each entry, you are to give your supporting reasons. Do not consider income tax aspects of the transaction.

GROUP II

(Estimated time—75 to 105 minutes)

(Answer any three questions in this group. If more are answered, only the first three will be considered.)

Number 5

In its financial statements for 1954 the Plate Glass Company reports an item—*Deferred Federal Income Tax, $351,000.* The president in his letter to stockholders states that this is in connection with accelerated amortization allowed under *certificates of necessity.*

a. Explain the nature of this item on the financial statement, and the accounting theory involved in this procedure.

b. Assuming that this is the first year that such an item has appeared, give the journal entries which were probably made to record this item, and entries which will affect this account in future years. Entries which will be repeated over a number of years may be so labeled. (Assume a 20-year life and a cost of $4,500,000 for the assets involved.)

Number 6

The capital and surplus section of the Jones Company's balance sheet at December 31, 1955 was as follows:

Common stock—$100 par (Authorized 50,000 shares, issued and outstanding 10,000 shares)	$1,000,000
Paid-in surplus	200,000
Retained earnings	100,000
	$1,300,000

On January 2, 1956, having idle cash, the company repurchased 400 shares of its stock for $50,000. During the year it sold 100 of the reacquired shares at $135 per share, sold 100 at $122.50 per share and legally retired the remaining 200 shares.

a. Discuss the accounting principles involved in handling these transactions, including consideration of possible alternatives.

b. Prepare journal entries for each transaction in accordance with the principles which you believe should be applied.

Number 7

a. In considering the merits of using price indexes for the purpose of converting the accounting data as reflected in the conventional historical accounts, some people have suggested that these price-level adjustments should be confined to the fixed assets and related depreciation.

   What can be said in favor of such a proposal? Against it?

b. The price index rose from 125 to 175 during the previous year and from 175 to 225 during the current year. The dollar sales during the previous year were $240,000 and during the current year were $300,000.

   (1) For comparative income statement purposes you are to convert the sales figures for both years to the price level existing at the end of the current year. You are to assume that sales were made uniformly throughout both years, and that the change in price level was also uniform.

   (2) What additional information is revealed by a comparison of the converted figures? How do you interpret them?

Number 8

During the current year Company P acquired an 80% interest in the capital stock of two existing companies: S and T. Company P issued 100,000 shares of its $50 par value common stock in exchange for 40,000 shares of the $25 par value common stock of Company S. P Company acquired 800 shares of T Company no par common for $400,000 in cash. The investment in S was recorded at the par value of the stock issued and the investment in T at the cash price.

In the process of consolidating the three companies, it is determined that as of the date of acquisition the book value of the investment in S and in T is smaller than the book value of an 80% interest in the net assets of the respective companies as follows: S Company—$800,000; T Company—$160,000. At the time of the acquisition the approximate quoted market values of the common shares of the three companies were as follows: P—$60-65; S—$150-160; T—$480-495.

a. Explain the possible reasons for the cost of stock of a subsidiary being less than the book value of the underlying net assets on the books of the subsidiary, and recommend how these amounts should be handled on the consolidated financial statements in each situation, giving reasons for your recommendation.

b. Discuss the specific situation of consolidating S Company and T Company in view of the data given and the reasons you present in (a) above.

Examination, November, 1957

EXAMINATION IN ACCOUNTING PRACTICE—PART I

November 6, 1957; 1:30 to 6:00 p.m.

Number 1 (Estimated time—30 to 40 minutes)

A, B and C became partners on January 1, 1947. There was no provision in their original agreement as to sharing profits, but the agreement did provide that each partner would be entitled to $5,000 salary as a distribution of profits. The capital contributions were: A—$20,000; B—$30,000; and C—$50,000.

As of January 1, 1952 the partnership agreement was amended to provide thereafter for distribution of profits after salaries in the original capital ratios. This agreement is still in effect.

You have been called in as of December 31, 1956 to review their books and records and to advise them of their proper capital balances.

An examination of their records disclosed the following:

1. Assets per books 12/31/56—$270,000. Liabilities—$95,000.
2. Total withdrawals made and charged against capital:
   A and B—each $3,000 per year for the ten years.
   C—$3,000 per year for the first five years and
   $4,000 per year since.
3. Profit per books:

1947	$15,000	1952	$14,000
1948	17,000	1953	16,000
1949	18,000	1954	20,000
1950	14,000	1955	18,000
1951	16,000	1956	22,000

4. The review of the principal records revealed that some material errors had been made at various times. These errors were as follows:
   (a) December 31, 1949 inventory was overstated by $15,000
   (b) December 31, 1949 depreciation was overstated by $3,000
   (c) December 31, 1951 inventory was overstated by $8,000
   (d) December 31, 1954 depreciation was understated by $3,000
   (e) December 31, 1956 inventory was understated by $20,000

Prepare any adjusting entries needed at December 31, 1956 to properly reflect the capital accounts of the partners. Support your entries with schedules in good form.

Number 2 (Estimated time—30 to 40 minutes)

You have been assigned to verify the provision for Federal income taxes for the calendar year 1956 for X Company. The Company has provided $514,500 which is based on the net income before Federal income taxes per books of $1,000,000.

During the year the Company purchased new machinery and equipment for $500,000. These assets have an estimated life of 10 years, and depreciation of $25,000 computed on the straight-line basis has been recorded on the books. Because the Company's working capital is low, it has been decided that the declining balance method of depreciation will be used so that the current year's tax liability will be kept at a minimum. The Company's books are to be adjusted accordingly.

In order to raise funds to purchase the machinery and equipment, the Company had its wholly-owned subsidiary, X Corporation, pay a dividend of $200,000. An additional $200,000 was borrowed from a bank. Part of the proceeds from an anticipated refund of Federal income taxes for the calendar years 1953 and 1954 will be used to pay the bank loan. The refund arises from the carry-back of $1,750,000 of the $2,185,000 loss from operations sustained in 1955. The balance of the cost of the machinery and equipment was provided from the net proceeds from the sale of stock in an unrelated company for $75,000 which cost $125,000 in 1950, and of land for $35,000 which cost $43,000 when it was acquired in 1942 to store scrap and raw materials applicable to U.S. Government contracts.

The provision for bad debts of $50,000 is ½ of 1% of gross sales. The provisions for prior years computed on the same basis have been allowed through the year 1953, which was the last year examined by the Internal Revenue Service. In addition, account balances totaling $7,200 were charged to miscellaneous expense and recoveries of accounts previously written off totaling $2,100 were credited to other income.

The Company maintains a reserve for returns and allowances which has been charged with $32,400 allowed to customers during the year. The provision for the current year, $35,000, appears to be reasonable based on past experience and the volume of sales.

Charitable contributions to educational institutions, which amounted to $12,825 last year were reduced to $5,200 in the current year due to the low working capital.

The audit has been completed except for verification of the provision for Federal income taxes. Other adjustments to be made will be for an overstatement of the ending inventory, $65,000, and the accrual for year-end bonuses, $25,500, which as in prior years has been computed by your firm after the necessary figures were obtained.

Prepare a schedule in good form showing the adjustments necessary and the computation of X Company's Federal income tax liability for the calendar year 1956 and the amount of the adjustment to be made. (*The tax rates amount to 30% on the first $25,000 of income and 52% on the excess.*)

Number 3 (Estimated time—22 to 35 minutes)

The president of the Farmbrook Manufacturing Company is concerned because his gross profit has decreased from $130,000 in 1955 to $87,960 in 1956. He asks you to prepare an analysis of the causes of change.

You find that the company operates two plants, each as a separate unit. Investigation reveals the following information:

Plant No. 1 (Makes a variety of products)

	1956	1955
Sales	$200,000	$300,000
Cost of sales	160,000	210,000
Gross profit	$ 40,000	$ 90,000

Plant No. 2 (Makes only one product)

	1956		1955	
	Amount	*Per unit*	*Amount*	*Per unit*
Sales	$112,200	$10.20	$100,000	$10.00
Cost of sales	64,240	5.84	60,000	6.00
Gross profit	$ 47,960	$ 4.36	$ 40,000	$ 4.00

Prepare a detailed analysis of the causes for the change in gross profit for each of the plants to the extent that the above data permit such an analysis. Critical comment on the analysis is not required.

Number 4 (Estimated time—28 to 40 minutes)

The Valley Manufacturing Company was incorporated on January 2, 1956, but was unable to begin manufacturing activities until July 1, 1956 because new factory facilities were not completed until that date.

The Land and building account at December 31, 1956 was as follows:

Date	*Item*	*Amount*
January 31, 1956	Land and building	$ 98,000
February 28, 1956	Cost of removal of building	1,500
May 1, 1956	Partial payment of new construction	35,000
May 1, 1956	Legal fees paid	2,000
June 1, 1956	Second payment on new construction	30,000
June 1, 1956	Insurance premium	1,800
June 1, 1956	Special tax assessment	2,500
June 30, 1956	General expenses	12,000
July 1, 1956	Final payment on new construction	35,000
December 31, 1956	Asset write-up	12,500
		$230,300
December 31, 1956	Depreciation—1956 at one per cent	2,300
	Account balance	$228,000

The following additional information is to be considered:

(1) To acquire land and building the company paid $48,000 cash and 500 shares of its five per cent cumulative preferred stock, par value $100 per share.

(2) Cost of removal of old buildings amounted to $1,500 with the demolition company retaining all materials of the building.

(3) Legal fees covered the following:

Cost of organization	$ 500
Examination of title covering purchase of land	1,000
Legal work in connection with construction contract	500
	$2,000

(4) Insurance premium covered premiums for three-year term beginning May 1, 1956.

(5) General expenses covered the following for the period from January 2, 1956 to June 30, 1956:

President's salary	$ 6,000
Plant superintendent covering supervision of new building	5,000
Office salaries	1,000
	$12,000

(6) The special tax assessment covered street improvements.

(7) Because of a general increase in construction costs after entering into the building contract, the Board of Directors increased the value of the building $12,500, believing such increase justified to reflect current market at the time building completed. Earned surplus was credited for this amount.

(8) Estimated life of building—50 years.
Writeoff for 1956—one per cent of asset value (1% of $230,000, $2,300).

a. Prepare entries to reflect correct land, building and depreciation allowance accounts at December 31, 1956. Post the entries for land and building to skeleton "T" ledger accounts or list them in a schedule.

b. Show the proper presentation of land, building and depreciation allowance on the balance sheet at December 31, 1956.

Number 5 (Estimated time—35 to 55 minutes)

You are a senior accountant responsible for the annual audit of Black, Inc., for the year ended 12/31/56. The information available to you is presented below. You may assume that any pertinent information not presented below has already been checked and found satisfactory.

(1) Excerpts from Trial Balance 12/31/56

	Debit	*Credit*
Surplus	$	$40,000
Inventory reserve		7,500
Capital stock (600 shares)		60,000

(2) The books have not been closed but all adjusting entries which the company expects to make have been posted. Their trial balance shows a $15,000 net profit for the year.

(3) Selected Ledger Accounts

Surplus

8/ 6/56	CD62	$ 160	12/31/55	Balance	$52,960
10/10/56	J34	10,000	4/29/56	CR8	200
12/31/56	J40	3,000			

(*Note: The balance at 12/31/55 agrees with last year's working papers and represents the net difference over the years between credits from the profit and loss account and debits for dividends.*)

Inventory reserve

9/26/56	CD78	$ 500	6/30/56	J19	$ 5,000
			12/31/56	J40	3,000

(4) Analysis of Selected Cash Receipts

Date	*Page*	*Account credited*	*Explanation*	*Amount*
4/29/56	8	Capital stock Surplus	Sold $100 par stock @ $102	$10,000 200
10/10/56	20	Building	See J34	20,000

(5) Analysis of Selected Cash Disbursements

Date	*Page*	*Account debited*	*Explanation*	*Amount*
8/ 6/56	62	Surplus	Freak accident to company truck not covered by insurance; repair by Doe & Co.	$ 160
9/26/56	78	Inventory reserve Purchases	Purchase of materials (X Co.) to be used on orders taken prior to 6/30/56. $500 is price increase since 6/30/56.	500 6,300

(6) Selected Entries in General Journal

Date	*Page*	*Entry and Explanation*	*Debit*	*Credit*
6/30/56	19	Inventory loss (P & L)	$ 5,000	
		Inventory reserve		$ 5,000
		Provision voted by Board of Directors for estimated future price increases in materials needed to complete orders on hand. (*Note: Orders do not represent contractual obligations.*)		
10/10/56	34	Reserve for depreciation	50,000	
		Surplus	10,000	
		Building		60,000
		Sale of main office bldg., moved to rental quarters downtown. (See CR20)		
12/31/56	40	Surplus	3,000	
		Inventory reserve		3,000
		Provision to value materials inventory at lower of cost or market in accordance with company pricing policy. Cost . . . . $30,000 Market . . . . . . 28,000 $ 3,000		

You are to prepare the following in good form:

a. Schedule of recommended adjusting entries to be placed on the books to state the Stockholders' equity accounts in accordance with accepted accounting principles.

b. Statement of Retained earnings for 1956.

c. Stockholders' equity section of balance sheet.

Number 6 (Estimated time—40 to 60 minutes)

The Investment Company was organized on October 1, 1956, with an initial investment of $100,000 in common capital stock of $10 par value.

The corporation's charter authorizes it to buy and sell real estate in its own name (not a real estate dealer) and to buy, hold and sell mortgages.

Transactions for the year ended September 30, 1957 were as follows:

Purchases and Sales of Real Estate

Deal No.	*Date purchased*	*Total cost*	*Date sold*	*Sale price*	*Down payment*	*Collected on mtg. to 9/30/57*
101	10/5/56	$ 9,000	11/15/56	$12,000	$1,000	$ 800
102	11/9/56	8,000	1/10/57	12,000	3,400	600
103	12/1/56	11,000	3/15/57	16,000	2,200	13,800*
104	12/4/56	5,500	5/10/57	10,000	2,000	600

* The land contract received on deal 103 was subsequently sold by The Investment Company to an individual investor for $10,700. At that time the unpaid mortgage amount was $13,400.

Land contracts (mortgages) were given to the company by the purchaser of the property for the difference in the sales price and the down payment at the time of completing the deal. The ordinary life of a land contract is 10½ years.

The Investment Company assumed existing mortgages at the time of purchasing three of the properties as follows:

Deal No.	*Mortgage assumed on purchase*	*Unpaid balance 9/30/57*
101	$5,500	$5,200
102	3,500	3,250
104	3,150	(see below)

When Deal 104 was sold on May 10, 1957 the purchaser bought it subject to the existing mortgage, which at date of sale had a balance due of $3,000. Therefore, the land contract which he gave to the company was only for $5,000. On Deals 101 and 102 the company will have to pay off the mortgages before giving final title to the purchasers.

Transactions in Investments in Mortgages were as follows:

Mortgage No. 1—6% interest (5 years to maturity), face amount—$10,000
Purchased on October 1, 1956 for $8,000
Principal collected during fiscal year—$2,000
Sold on June 1, 1957 for $7,200

Mortgage No. 2—6% interest (2 years to maturity), face amount—$8,000
Purchased on December 1, 1956 for 7,040
Principal collected during fiscal year—$2,000

a. The company will use the installment sales method of accounting for its income and gain from real estate transactions.
   (1) Compute the total deferred income on real estate as of September 30, 1957.
   (2) Compute the income earned and gain or loss for the year on real estate transactions. Prepare all computations in good form.

b. Determine the gains and income, other than regular interest, from the transactions in "Investments in Mortgages" for the year.

c. State how the taxable income for Federal income tax purposes would differ from the income reported to stockholders.

EXAMINATION IN ACCOUNTING PRACTICE—PART II

November 7, 1957; 1:30 to 6 p.m.

GROUP I

(Required)

Number 1 (Estimated time—30 to 45 minutes)

The records of Taxpayer Manufacturing Corporation showed the following transactions for the fiscal year ended May 31, 1957:

Gross receipts from business exclusive of the following items	$400,000
Dividends received from domestic corporation	100,000
Issuance on June 1, 1956 of $10,000 par value of the Corporation's own debenture bonds dated June 1, 1956 due June 1, 1966	11,000
Proceeds from sales on May 31, 1957:	
100 shares of Corporation's own common stock ($10 par value each) purchased for $1,100 in 1954	1,000
100 shares of X Corporation common stock purchased for $10,500 on December 31, 1956, as a temporary investment	10,000
Machinery (used in the business) acquired on May 31, 1956 at list price of $5,000 less $1,000 allowance on machinery traded-in which was purchased on May 31, 1953 for $4,000. (Estimated useful life of machinery of this type is five years)	4,000
Truck used by the Corporation for delivering merchandise, purchased January 31, 1957, for $6,000. (Estimated useful life, four years)	5,000
Land used for storage purposes in the business, acquired in 1954 for $3,000	6,000
Total	$537,000

Costs and expenses including all allowable interest and depreciation (straight-line basis) but exclusive of the following items	$350,000
Charitable contributions	25,000
Dividends paid in cash	100,000
Purchase on December 1, 1956 of 100 shares of the Corporation's own common stock (par value $10 a share)	900
Total	$475,900

Prepare a work sheet showing details of the computation of the corporate Federal income tax for the fiscal year ended May 31, 1957. (*The tax rates amount to 30% on the first $25,000 of income and 52% on the excess.*)

GROUP II

(Estimated time—150 to 225 minutes)

(Solve any three problems in this group. If more are solved, only the first three will be considered.)

Number 2

You have completed the field work in connection with your audit of The Bancroft Corporation for the year ended December 31, 1956. You have decided to include a Statement of Source and Application of Funds in your long-form report. The following schedule shows the balance sheet accounts at the beginning and end of the year:

	December 31, 1956	*December 31, 1955*	*Increase or (Decrease)*
Cash	$ 282,400	$ 320,000	$(37,600)
Accounts receivable	490,000	410,000	80,000
Inventory	695,000	660,000	35,000
Prepaid expenses	10,000	8,000	2,000
Investment in Subsidiary Co.	106,000	......	106,000
Cash surrender value of life insurance	2,100	1,800	300
Machinery	186,600	190,000	(3,400)
Buildings	566,500	507,500	59,000
Land	52,500	52,500	.....
Patents	71,000	60,000	11,000
Goodwill	40,000	50,000	(10,000)
Bond discount and expense	4,680	......	4,680
	$2,506,780	$2,259,800	$246,980

Accrued taxes payable	$ 92,000	$ 80,000	$ 12,000
Accounts payable	301,280	280,000	21,280
Dividends payable	60,000	......	60,000
Bonds payable—4%	125,000	......	125,000
Bonds payable—6%	......	100,000	(100,000)
Allowance for bad debts	45,300	40,000	5,300
Accumulated depreciation—building	407,000	400,000	7,000
Accumulated depreciation—machinery	141,000	130,000	11,000
Premium on bonds payable	......	1,600	(1,600)
Capital stock—no par	1,301,200	1,453,200	(152,000)
Paid in capital	14,000	......	14,000
Reserve for plant expansion	10,000	......	10,000
Retained earnings	10,000	(225,000)	235,000
	$2,506,780	$2,259,800	$246,980

STATEMENT OF RETAINED EARNINGS

December 31, 1955	Balance (deficit)	$(225,000)
March 31, 1956	Profit for first quarter of 1956	25,000
April 1, 1956	Transfer from capital surplus	200,000
	Balance	$ —0—
December 31, 1956	Profit for last three quarters of 1956	80,000
	Dividend declared—payable January 20, 1957	(60,000)
	Reserve for plant expansion	(10,000)
	Balance	$ 10,000

Your working papers contain the following information:

(1) On April 1, 1956 the existing deficit was written off against capital surplus created by reducing the stated value of the no-par stock.
(2) On November 1, 1956, 8,000 shares of no-par stock were sold for $62,000. The board of directors voted to regard $6 per share as stated capital.
(3) A patent was purchased for $16,000.
(4) Machinery was purchased for $4,600 and installed in December 1956. A check for this amount was sent to the vendor in January 1957.
(5) During the year machinery which had a cost basis of $8,000 and on which there was accumulated depreciation of $5,000 was sold for $1,000. No other fixed assets were sold during the year.
(6) The 6%, 20-year bonds were dated and issued on January 2, 1944. Interest was payable on June 30 and December 31. They were sold originally at 104. These bonds were retired at 101 and accrued interest on March 31, 1956.
(7) The 4%, 40-year bonds were dated January 1, 1956 and were sold on March 31 at 97 and accrued interest. Interest is payable semi-annually on June 30 and December 31. Expense of issuance was $1,020.
(8) The Bancroft Company acquired 80% control in Subsidiary Co. on January 2, 1956 for $100,000. The income statement of Subsidiary Co. for 1956 shows a net income of $7,500.
(9) Extraordinary repairs to buildings of $7,000 were charged to accumulated depreciation—building.

From the above information prepare a statement accounting for the decrease in net working capital (Statement of Source and Application of Funds) and a schedule of working capital changes. A worksheet is not necessary, but the principal computations should be supported by schedules or skeleton ledger accounts.

Number 3

The fiscal year of The X Company, a cotton print-cloth manufacturer, ends on September 30. Inventories of finished cloth, cloth in process, and raw cotton are stated in the balance sheet at the cost of the raw material content (based on the last-in, first-out method), plus current manufacturing costs applicable thereto. In connection with preparation of interim statements you have the following data:

Physical inventory pounds at beginning and end of the period were as follows:

	9/30/55	3/31/56
Finished cloth	254,000	462,000
Cloth in process (considered to average ½ finished)	714,000	788,000
Raw cotton	1,965,000	1,100,000
	2,933,000	2,350,000

The "lifo" cost of the raw material content of the beginning inventories (including waste) was built up as follows:

	Pounds	*Price Per Pound*	*Amount*
Inventory 9/30/41	1,675,000	$ .110	$184,250
Increase 1943	805,000	.180	144,900
Increase 1949	376,000	.340	127,840
Increase 1954	55,000	.345	18,975
Increase 1955	246,000	.350	86,100
Inventory 9/30/55	3,157,000	$ .178	$562,065

During the six-months period the Company purchased 6,291,000 pounds of cotton for an average price of $.37 per pound, and sold 6,535,000 pounds of cloth for an average price of $.84 per pound. Market prices at March 31, 1956 were $.375 per pound for cotton and $.85 per pound for cloth.

The value of waste recovery is deducted from processing cost and need not be considered.

For preparation of interim financial statements as of March 31, 1956 you are to:

a. Compute the pounds of loss due to "waste" during the six months.

b. Compute the value of cotton included in the inventories as of March 31, 1956.

c. Compute the "reserve for replacement" of the decrease in "lifo" quantities as of March 31, 1956. The Company intends to maintain its fiscal year-end inventory quantity position.

Number 4

You are engaged to audit the records of the Pacific Import Company which has not previously been audited. The trial balance at December 31, 1956 follows:

Debits	*Home Office*	*Branch*
Cash	$ 15,000	$ 2,000
Accounts receivable	20,000	17,000
Inventory—December 31, 1956	30,000	8,000
Fixed assets—Net	150,000	
Branch office current account	44,000	
Cost of sales	220,000	93,000
Expenses	70,000	41,000
Total	$549,000	$161,000

Credits	*Home Office*	*Branch*
Accounts payable	$ 23,000	
Mortgage payable	50,000	
Capital stock	100,000	
Retained earnings—January 1, 1956	26,000	
Sales	350,000	$150,000
Accrued expenses		2,000
Home office current account		9,000
Total	$549,000	$161,000

The following additional information is to be considered:

(1) The branch receives all of its merchandise from the home office. The home office bills goods to the branch at 125% of cost. During 1956 the branch was billed for $105,000 on shipments from the home office.

(2) The home office credits sales for the invoice price of goods shipped to the branch.

(3) On January 1, 1956 the inventory of the home office was $25,000. The branch books showed a $6,000 inventory.

(4) The home office billed the branch for $12,000 on December 31, 1956 representing the branch's share of expenses paid at the home office. The branch has not recorded this billing.

(5) All cash collections made by the branch are deposited in a local bank to the account of the home office. Deposits of this nature included the following:

Amount	*Date Deposited by Branch*	*Date Recorded by Home Office*
$5,000	December 28, 1956	December 31, 1956
3,000	December 30, 1956	January 2, 1957
7,000	December 31, 1956	January 3, 1957
2,000	January 2, 1957	January 5, 1957

(6) Expenses incurred locally by the branch are paid from an imprest bank account which is reimbursed periodically by the home office. Just prior to the end of the year the home office forwarded a reimbursement check in the amount of $3,000 which was not received by the branch office until January 1957.

(7) It is not necessary to make provisions for Federal income tax.

a. You are to prepare a columnar worksheet for the company and its branch with columns for "Trial balance," "Adjustments and eliminations," "Branch income statement," "Home office income statement," and "Balance sheet." Complete the worksheet and key and explain all adjustments and eliminations. (The income statements should be on a cost basis.)

b. Prepare a reconciliation of branch office and home office current accounts showing the corrected book balances.

Number 5

From the following information about the Water Department of the City of X, prepare a worksheet showing the original trial balance, adjustments, and the extended profit and loss and balance sheet accounts. Also prepare in proper form fund balance sheets and operating statement for the year ended December 31, 1956, for the Water Department.

Ledger Balances December 31, 1956

Cash—operating fund	$ 588,800	Accounts payable—township	$ 56,000
Cash—consumers' deposits	17,000	Water consumers' deposits	67,000
Postage on meter	1,000	Revenue bonds payable	300,000
Accounts receivable:		Accumulated depreciation	1,200,000
Consumer billing	65,000	Surplus	4,500,000
Service	17,000	Revenue	1,500,000
Sundry	700	Expense:	
Due from other funds	—	Production	340,000
Supplies inventory	140,000	Distribution	151,000
Merchandise on order and in transit	145,000	Office	90,000
Investments — consumers' deposits	50,000	Administrative and general	105,000
Property	6,000,000	Cost of installations, repairs and parts	140,000
Unfilled orders and contracts	145,000	Interest on consumers' deposits	600
Warrants payable	50,100	Interest on bonds	9,000
Due to other funds	—	Allowances and adjustments	5,000
Advance service payments	—		
Accounts payable—trade	47,000		
(CONTINUED)			

NOTE: Revenue bonds mature serially $30,000 each year.

Examination of the records discloses the following additional data:

(1)	Included in error in accounts payable—trade:		
	(a) For reimbursement of metered postage		$ 500
	(b) Due to other City funds		18,500
(2)	Items included in book inventory that were not received until 1957		2,000
(3)	Computation of inventory items chargeable to distribution expense understated		1,000
(4)	Classified as accounts payable trade, should be accounts payable township		10,000
(5)	Unfilled orders not of record		1,000
(6)	1957 expense purchases recorded as 1956 liabilities and charged to expense as follows:		
	(a) Production expense	$500	
	(b) Distribution expense	500	
	(c) Office expense	500	
	(d) Administrative and general expense	500	
(7)	Included in accounts receivable—service, but actually due from other funds		500

(8)	Credit balances included in accounts receivable—service, advance service payments	1,000
(9)	Included in accounts receivable sundry but due from other City funds	50
(10)	Required adjustment to reduce unfilled orders and contracts to proper estimates	2,600
(11)	Purchase order included in unfilled orders and contracts. This order a duplication of previously recorded expenditure	40,000
(12)	Unrecorded receivable from township for water consumed	5,000

EXAMINATION IN AUDITING

November 7, 1957; 9 a.m. to 12:30 p.m.

GROUP I

(Estimated time—75 to 100 minutes)

(Answer any four questions in this group. If more are answered, only the first four will be considered.)

Number 1

The following auditing procedures are customarily applied in connection with the verification of cash balances or the testing of cash transactions. Indicate a type of irregularity which could be expected to be disclosed by the application of each procedure and explain how the procedure would disclose the irregularity.

a. Verification of the composition of deposit slips.
b. Comparison of deposits as shown by the bank statement for several days prior to the end of the period under examination with receipts as shown by the cash book.
c. Comparison of checks returned with the next subsequent bank statement to the bank statement and to the list of checks outstanding as of the date of the bank reconciliation.
d. Reconcilement of cash receipts by months as shown by the cash book with deposits as shown by the bank statements.

Number 2

The A.B.C. Company has followed the practice for many years of cutting off sales as of the 25th of the month. As of December 31, 1956 the company decided to cut off sales as of the last day of the month rather than as of the 25th of the month.

a. If the effect of the foregoing change in accounting practice on 1956 net income is deemed to be not material:
   (1) What would be your recommendation to the company as to disclosure in the financial statements or the footnotes thereto? If any disclosure is desirable, suggest the exact manner and wording you would propose.
   (2) What would you say with regard to this change in accounting practice in your short-form report? Explain.
b. If this change in accounting practice is deemed to have a material effect on 1956 net income:
   (1) What would be your recommendation to the company as to disclosure in the financial statements or the footnotes thereto? If any disclosure is required, suggest the exact manner and wording you would propose.
   (2) What would you say with regard to this change in accounting practice in your short-form report? Explain.

Number 3

a. You are engaged in the conduct of an examination of the financial statements of a central school district. The district has an elected treasurer and a clerk of the Board of Education who is appointed by the Board. Each of these officers keeps independent accounts with regard to the monies received and with regard to disbursements authorized from the school bank accounts. During the course of your examination you learn that the treasurer of the school district is manager of the local branch of a bank, and that the clerk of the Board of Education is one of the principal employees in the same branch of the bank. You have sent to this bank in which various accounts are carried for the school district your regular form for confirmation of bank balances and for confirmation of liabilities, and they have been received back by you properly filled out and signed for the bank by its manager, who also is the treasurer of the school district.

All information in the confirmations appears to be correct in accordance with the records which you are examining.

Discuss the value of these confirmations in these circumstances. What further steps, if any, would you take with regard to these confirmations?

b. The cashier of a bank is also treasurer of a local charity. He is authorized to purchase $10,000 U. S. bonds for the bank and a similar amount for the charity. He makes both purchases but misappropriates the bonds belonging to the charity. When an audit is made of the charity, the treasurer borrows the bonds from the bank and places them in the charity's safe deposit box.

What internal controls would you recommend for the charity to prevent the occurrence of this manipulation?

Number 4

A and B form a corporation and transfer to it oil leases owned by them equally for which they had paid $30 in capitalized fees. They had also paid $1,280 for delay lease rentals which they had charged to expense in the year paid by them as individuals. The transferor stockholders had no other costs or expenses applicable to these leases. At the time of the transfer there were favorable geological and geophysical reports on the property but there had been no production in the area. The board of directors of the new corporation issued $300,000 par value common stock for the leases, one-half the stock going to A and one-half to B. A and B donated concurrently one-half of their respective shares to the corporate treasury to be sold at par for working capital.

a. Discuss the proper balance sheet presentation of the leases and of the capital and donated stock.

b. What would be the basis of the leases to the corporation for income tax purposes?

c. What audit procedures would you apply to the leases?

d. Must this stock issue be reported or registered with the S.E.C.? Explain.

Number 5

The auditing short-form report usually contains a sentence like this: *Our examination was made in accordance with generally accepted auditing standards and included all auditing procedures which we considered necessary in the circumstances.*

a. Distinguish between auditing standards and auditing procedures.

b. Quote or state in your own words four generally accepted auditing standards.

Number 6

Archer Department Store, Inc., uses the retail inventory method. It takes a complete physical inventory at selling prices at the close of its year as a basis for recording shortages.

Outline briefly a program of examination for the merchandise inventory of Archer Department Store, Inc., in connection with a regular annual audit.

GROUP II

(Answer all questions in this group)

Number 7 (Estimated time—17 to 25 minutes)

Your client, a distiller of alcohol, suggests that it is not necessary for you to observe the taking of physical inventories at his plants. He points out that the Treasury Department's Alcohol Tax Unit checks regularly on his inventories of raw materials, work in process, finished product and revenue stamps. Procedures followed by the Tax Unit's agents include auditing of production, sales and other reports and the taking of physical inventories at unannounced intervals. Your client maintains perpetual inventory records.

Assuming that you agree to the client's suggested restriction of the scope of your audit, answer the following two questions. (In each case, your answer should include a discussion of the specific effects of such restriction on your short-form report.)

a. Your review of such of the records of the tax audits as are available and your appraisal of the procedures employed in such audits convince you that the client's record of inventory quantities can be relied upon. Would you be justified in accepting such independent verification by a governmental agency in lieu of your own observation and in consequently giving an unqualified opinion? Discuss fully.

b. Your review of the tax audit records and procedures does not satisfy you that you would be justified in relying solely on that verification of quantities. What effects would your omission of observation procedures have on your short-form report? Discuss fully.

Number 8 (Estimated time—30 to 45 minutes)

You have been engaged by The Louis Research Corporation to make an examination of the balance sheet of the Rogers Corporation as of December 31, 1956. Your client is considering the acquisition of the latter corporation by the purchase of its capital stock, and intends to use your report in connection with purchase contract negotiations. Furthermore, your client has stated that since the purchase has been motivated by the need for existing manufacturing facilities in a new marketing area, it is understood that your work under this engagement would be limited to that necessary to enable you to certify to the balance sheet but not to the statement of income and surplus.

This is the first time that the financial statements of the Rogers Corporation have been examined by independent public accountants.

A physical inventory will be taken by the Rogers Corporation as of the examination date.

Taking into consideration the fact that your certificate will only relate to the financial position of the company at December 31, 1956 and that you wish to do the minimum amount of work needed:

a. State what work, if any, should be done in respect to the following income and expense accounts for the year: *(1) Sales; (2) Purchases; (3) Interest expense; (4) Taxes; (5) Legal expense; and (6) Maintenance and repairs.* Give the specific reasons for any procedures which you consider necessary.

b. State specifically what work, if any, should be done with respect to the balance sheet accounts at the beginning of the year. Give the reason for each procedure which you consider necessary.

Number 9 (Estimated time—28 to 40 minutes)

The review of the system of internal control by an independent certified public accountant is fundamental in every examination of financial statements, upon which he must express an opinion.

You have been engaged to examine the financial statements of a manufacturing company which pays all payrolls in currency.

a. State what questions you would ask in your review of the system of internal control and procedures relative to payrolls. (The answer may be in the form of an appropriate questionnaire.)

b. Give your reasons for asking the above questions, including an explanation of how you would use the questions in deciding on the effectiveness of the control over payrolls.

EXAMINATION IN COMMERCIAL LAW

November 8, 1957; 9 a.m. to 12:30 p.m.

(Answer any nine questions)

Number 1

a. As applied to the sale of goods, define the following terms:
   (1) *Express warranty.*
   (2) *Specific goods.*
   (3) *Unpaid seller's lien.*

b. Under what circumstances is there an implied warranty of fitness for a particular purpose?

Number 2

A CPA, in counting X Co.'s notes receivable at December 31, 1956 finds among them the following items, complete and regular except as indicated:

(1) Note payable to X Co. due 90 days after date. The note is dated August 1, 1950.
(2) Note payable to order of Jones, not indorsed. Jones is president of X Co.
(3) Note payable to bearer on demand which is undated.
(4) Note indorsed by payee, B, with a rubber stamp stating: *For deposit only, B.*
(5) Note indorsed by payee, C. The words *Without recourse* precede his signature.

On the facts stated, as to which of these notes might X Co. have difficulties in collecting? Explain. What might the company do to remove such difficulties and endeavor to make the notes realizable assets of the X Co.?

Number 3

a. What is a third party beneficiary contract?

b. Distinguish between third party beneficiaries who acquire legal rights as the result of such contracts and those who do not.

c. As to third party beneficiaries, define (1) *a creditor beneficiary,* and (2) *a donee beneficiary.*

Number 4

a. When a stockholder secures legal authorization to inspect corporate books of account, may he have a public accountant examine such books for him and make transcripts therefrom? Explain fully.

b. When a stockholder disposes of his stock, and is no longer a stockholder in fact, at what time, as to the corporation, do his liabilities terminate?

c. State four ways in which a corporation may succeed to the rights of another corporation.

d. So that the purchase may not be considered invalid, what three rules must be observed when a corporation purchases the entire assets of another?

e. Distinguish between *consolidation* and *merger of* corporations.

Number 5

a. In presenting a negotiable instrument for payment, what is necessary to make the presentation sufficient?

b. Under what circumstances is presentment of a negotiable instrument for payment excused or dispensed with?

c. Under what circumstances is it not necessary that notice of dishonor of a negotiable instrument be given to the drawer?

Number 6

a. Peter Muncie, a member of the general partnership of Duval and Muncie, in the course of the firm's business and acting within the scope of his apparent authority, received $500 in cash from George Pratt, a client of the firm, which was to be used by the partnership to acquire certain goods for Pratt. Instead Muncie misapplied the funds by converting them to his own personal use. Learning of the misapplication, Pratt made a demand upon the partnership for restitution. The firm maintained that Muncie was solely responsible in his individual capacity. Pratt thereupon instituted legal proceedings against the partnership.
Is the partnership bound to make good his loss? Explain.

b. Calvin Chandler is hired as an employee by the partnership of Blake and Armstrong. He makes no investment in the business, and his compensation is set at 10% of the profits of the partnership. Profits are ascertained semi-annually. Pending such semi-annual determination Chandler is given a drawing account against which he draws a fixed sum weekly with the understanding that all sums paid him from the drawing account are to be charged to his compensation resulting from a share of the firm's profits. A creditor of the firm seeks to maintain that Chandler is a partner in the firm on the ground that under the Uniform Partnership Act the receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner.
State whether, under the facts given, such a presumption may be drawn under the Uniform Partnership Act and explain application of the relevant provisions of the Act.

Number 7

a. Miller and Flood, certified public accountants, were employed for several years by The Retrograde Corporation to make annual audits. As a result of a change in control, the corporation discontinued the engagement of Miller and Flood and retained another firm of accountants. The Retrograde Corporation thereupon demanded of Miller and Flood surrender of all working papers prepared by the accounting firm in making audits for the corporation. Miller and Flood refused on the ground that the working papers were their property. The

corporation brought legal action to recover the working papers.
Should it succeed? State briefly what the law is, in general, as to ownership of accountants' working papers.

b. Day, a CPA who has been practicing alone, decides to "sell his practice" to Knight. As a part of the transaction Knight asks Day to turn over to him all his files and working papers. One client, John Doty, does not want Knight as his accountant and objects to the transfer of the files and working papers relating to his affairs.
Would such transfer be valid or desirable? Discuss fully.

Number 8

a. What is the basic duty of the *Federal Trade Commission?*
b. What is a *cease and desist* order as issued by the *Federal Trade Commission?*
c. Distinguish between *horizontal price-fixing* and *vertical price-fixing*. Are both illegal? Explain.

Number 9

a. Jones lends $100 to Smith, who agrees to repay in three months. A month after the loan, Jones requests security, and Reid, without asking or receiving payment for so doing, gives Jones a written promise to answer in the event of default by Smith. Smith defaults. Jones sues Smith, obtains judgment, and execution is issued and returned unsatisfied. Jones then sues Reid who claims there was no consideration for his promise.
Is his defense valid? Explain.
b. Assume the same situation as in (a), except that Reid made his written promise at the time the loan was made.
Would your answer be the same? Explain.
c. White seeks to buy a $30 article from the Black Company on credit. The company refuses unless Brown also promises to pay for it. Brown promises orally and the sale to White is made. When White fails to pay, the Black Company, taking no action against White, sues Brown. Brown's defense is that his promise is unenforcible because it was not in writing.
Is his defense valid? Explain.

Number 10

Evans was a stockholder in Moon and Blaine and knew that the corporation had purchased a tract of land on which seven houses were located and that the corporation wished to sell the houses and have them moved from the land. Evans obtained for valid consideration an option to purchase the houses for $19,000. Roberts owned seven building lots near the Moon and Blaine land. Evans, Roberts, and Porter entered into an agreement whereby it was agreed that the houses were to be purchased under Evans' option and moved to Roberts' lots and resold. Porter was to supervise the moving of the houses and was to resell them. Out of the moneys received from the sale of the houses and lots the purchase price of the houses and the cost of moving were to be paid and Roberts was to receive $5,000 for his lots. The balance of the amount received was to be divided equally among the parties. Prior to the expiration of the option and before Evans could act to exercise it, the houses were all destroyed by fire. Shortly thereafter Roberts sold his seven lots for $8,000.

a. Under the terms of their agreement, can Evans and Porter share with Roberts in the amount in excess of $5,000 received from sale of the lots? Explain.

b. Would Evans be liable to Roberts for breach of contract if Roberts had been unable to sell the lots? Explain.

c. Assume the houses were not destroyed and that Evans let the option lapse. Roberts and Porter sue Evans for damages for breach of contract. Evans pleads that there was no contract because of lack of consideration by Roberts and Porter since they did nothing. Is he justified? Explain.

Number 11

Timothy Bradner arranges to borrow $500 on a time note from Peter Fish. Prior to delivery of the executed note to Fish, John Keller indorses the note in blank as an accommodation for the payee Fish. Fish negotiates the note to Abraham Reade by special indorsement and Reade negotiates it by special indorsement to Richard Cavanagh, a holder in due course who in turn negotiates to Smith, also a holder in due course. The note is not paid when due and the following points are raised at a conference of the parties as to their respective rights and liabilities.

Comment on the validity of each contention.

a. Fish claims that as indorsers are liable in the order in which they indorse and Keller indorsed before him, Keller is liable to him.

b. Reade argues that although he indorsed before Cavanagh, he and Cavanagh had a special agreement whereby he would not be liable to Cavanagh in the customary order of liability. He produces incontrovertible proof of such agreement and contends this relieves him of liability to Cavanagh.

c. In the state, the law of which applies to all the parties on the instrument, incapacity to contract is a real defense at common law which makes void a negotiable instrument issued by a person lacking capacity to contract. Cavanagh contends he has no liability to Smith because Bradner, maker of the note, had no capacity to contract. Cavanagh produces incontrovertible evidence of Bradner's lack of capacity.

EXAMINATION IN THEORY OF ACCOUNTS

November 8, 1957; 1:30 to 5:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—15 to 22 minutes)

On October 1, 1956, the Television Company sold a set costing $400 to Jones for $600. Jones made a down payment of $150 and agreed to pay $25 the first of each month for eighteen months thereafter.

The first two installments due on November 1 and December 1, 1956, were paid. In 1957, five payments were made by Jones, who then defaulted on the balance of his payments. The set was repossessed on November 1, 1957. The company closes its books as of December 31.

a. Give three different amounts that might be shown as realized income for 1956 and indicate the circumstances under which each of these amounts would be acceptable.

b. Assuming that the repossessed television set has a wholesale value of $50 and a retail value of $75, prepare a journal entry to record the repossession under the "installment method" of accounting. Explain fully, the reasoning applicable to your entry.

Number 2 (Estimated time—18 to 28 minutes)

The invoice price of a machine is $10,000. Various other costs relating to the acquisition and installation of the machine amount to $2,000 and include such things as transportation, electrical wiring, special base, etc. The machine has an estimated life of 10 years, with no residual value at the end of that period.

The owner of the business suggests that the incidental costs of $2,000 be charged to expense immediately for the following reasons: (*1*) *if the machine should be sold, these costs can not be recovered in the sales price;* (*2*) *the inclusion of the $2,000 in the machinery account on the books will not necessarily result in a closer approximation of the market price of this asset over the years, because of the possibility of changing price levels; and* (*3*) *charging the $2,000 to expense immediately will reduce his Federal income taxes.*

Discuss each of the points raised by the owner of the business.

Number 3 (Estimated time—20 to 30 minutes)

At December 31, 1956, the Alta Company has outstanding purchase commitments for purchase of 50,000 gallons, at $2.00 per gallon, of a raw material to be used in their manufacturing process. The company prices its raw material inventory at cost or market, whichever is lower.

a. Assuming that the market price as of December 31, 1956 is \$2.05, how would this matter be treated in the statements? Explain fully.
b. Assuming that the market price as of December 31, 1956 is \$1.70 instead of \$2.05, how would you treat this situation in the statements? Give your reasoning.
c. Give the entry in January 1957 when the 50,000 gallon shipment is received, assuming the situation given in (b) above existed at December 31, 1956. Give an explanation of your treatment.

GROUP II

(Estimated time—37 to 55 minutes)

(Answer any two questions in this group. If more are answered, only the first two will be considered.)

Number 4

In the measurement of periodic net income, accountants conventionally (1) measure gross income of all kinds, (2) measure costs or expenses, and (3) subtract (2) from (1). In performing these operations they are said to be matching costs and revenue. The ideal matching would result from deducting from gross income of the period, the services and things consumed in producing the income without regard to the time the outlay was made.

a. State some of the more serious problems encountered in seeking to achieve the ideal measurement of periodic net income.
b. Explain what accountants do as a practical alternative.

Number 5

The retail method of inventory yields results which are essentially the same as those yielded by the lower of cost or market method.

a. Explain why this is so and give an illustration of how it reduces inventory to "market."
b. What conditions must exist for the retail method to give valid results?

Number 6

In order to clarify an apparent inconsistency, the president of the Moonoco Oil Company suggests including the following statement in the current annual report now being prepared:

On December 12, an eight per cent common stock dividend was distributed to stockholders, resulting in the transfer of \$3,690,000 from Earnings Employed in the Business to Stockholders' Equity. While the percentage of the stock dividend was the same as last year, the sum transferred to Stockholders' Equity was lower by nearly \$200,000.

The seeming inconsistency was caused by the requirement of regulatory author-

ities that the value of stock dividends on the company's books be related to the market value of the stock. As a result, the present year's dividend was valued at $65 per share as against $74 per share for last year's stock dividend.

As a partner of the public accounting firm of Ajax, Abercrombie, and Smith, which is making the annual audit of the Moonoco Oil Company, you think that such a statement may mislead the readers of the report even though the figures are correct.

a. State the rules for handling stock dividends in a situation such as described. Explain the reasoning supporting the rules.

b. What criticism do you have of the terminology used by the president? Explain.

GROUP III

(Estimated time—50 to 75 minutes)

(Answer any two questions in this group. If more are answered, only the first two will be considered.)

Number 7

You have been engaged to install a cost system for Martin Co. Your investigation of the manufacturing operations of the business discloses these facts:

(1) The company makes a line of lighting fixtures and lamps. The material cost of any particular item ranges from 15% to 60% of total factory cost, depending on the kind of metal and fabric used in making it.
(2) The business is subject to wide cyclical fluctuations since the sales volume follows new housing construction.
(3) About 60% of the manufacturing is normally done in the first quarter of the year.
(4) For the whole plant the wage rates range from $1.25 to $3.75 an hour. However, within each of the eight individual departments, the spread between the high and low wage rate is less than 5%.
(5) Each of the products made uses all eight of the manufacturing departments but not proportionately.
(6) Within the individual manufacturing departments, factory overhead ranges from 30% to 80% of conversion cost.

Based on the above information, you are to prepare a statement or letter for the president of the company explaining whether in its cost system Martin Co. should use:

a. A normal overhead rate or an actual overhead rate?

b. An overall overhead rate or a departmental overhead rate?

c. A method of factory overhead distribution based on: direct labor hours; direct labor cost; or prime cost?

Include the reasons supporting each of your three recommendations.

Number 8

Answer fully any four of the following five tax questions.

a. Your income tax client, Mr. A, sells property for $100,000. He has owned the property for many years. The purchaser paid your client $25,000 on delivery of the deed at April 1, 1956. The basis of the property sold was $50,000. An installment payment of $7,500 was due on January 1, 1957, under the terms of sale. On the morning of December 31, 1956, your client was tendered a check of $9,750 for the installment payment and interest due the following day. The check dated December 31 was drawn on the bank in which your client's office was located. Your client phones you immediately for advice. What advice would you give your client? Explain.

b. This is the calendar year 1957. Your client, Mr. B, had capital losses of $26,000 in 1952. In 1952 and in each year since then, he has had ordinary income of $5,000 per year after his deductions and personal exemptions. He has had no further capital gains or losses. He has 300 shares of stock on which the present market price exceeds his basis by $100 per share. This is the only thing that he has available for quick sale, but he does not want to dispose of the stock. Discuss the tax problem here.

c. Your client, Mr. C, and his attorney consult you about the tax aspects of Mr. C's will. His gross estate, consisting entirely of separate property, would apparently amount to about $120,000 if he were to die this year. He has no debts. Both Mr. C and his wife are 65 years old. They have an adult married daughter who is 35 years old. The wife is named the sole beneficiary of the will. Discuss the tax problem involved here.

d. On June 3, 1957 XY Corporation distributed to its stockholders shares of stock in another corporation which cost XY Corporation $10,800. The stockholders immediately sold the stock they received for $120,000. At the end of 1957 the books of the corporation showed retained earnings available for dividends of $80,000 before considering the above-mentioned dividend. No other dividends were paid in 1957.

   (1) What entry or entries should be made by XY Corporation? State the applicable general rule.

   (2) Jones owns 10% of the stock of XY Corporation which he acquired in 1952 for $20,000. How should he treat in his tax return the proceeds ($12,000) from the sale of the stock which the XY Corporation distributed to him? State the applicable rules.

e. Mr. E, your tax client, made a loan of $1,000 to a business friend during 1957. The friend was incapacitated permanently by an automobile accident in 1957, and his business became insolvent. At the end of the year 1957, there seemed no remote possibility that anything could ever be realized on the note. Mr. E's income for the year consisted of a salary of $12,000, a long-term capital gain of $2,000 and dividends of $700 received from U. S. Steel. He paid no interest. Contributions were $500. He lived in a state that levied no personal income tax. His other deductions were negligible. Mr. E was single and had no dependents. On what net income was his tax computed?

Number 9

You are to criticize the following statement, considering mainly its function and content. (There are differences of opinion concerning the general form of such a statement and the terminology used. You need not concern yourself with these matters in your criticism except where you believe them to be essential to the accomplishment of the statement's function.) Include in your discussion mention of specific items which the data supplied lead you to believe: (1) may have been omitted incorrectly from the statement, (2) should have been excluded from the statement. For each item which you mention, give your reason for inclusion or deletion and state how you would treat the item. You need not prepare a revised statement. (There are no arithmetic mistakes in the statement.)

ENAK MANUFACTURING CO., INC.

Statement Showing Causes of Net Change in Working Capital

Funds were obtained from:		
Operations (net income transferred to retained earnings		$179,001.12
Current assets used up in year's operations:		
Cash on hand and in banks	$ 33,427.73	
Postal stamps	20.00	33,447.73
Increase in common stock outstanding	$ 10,000.00	
Increase in capital surplus	20,000.00	30,000.00
		$242,448.85
Funds were applied to:		
Payments of cash dividends		$ 35,442.00
Declaration of stock dividends (not yet issued)		27,400.00
Investment in additions to:		
Accounts receivable—trade	$ 10,004.43	
Notes receivable—trade	2,500.00	
Inventories	101,442.21	
Marketable securities	10,440.00	
Cash surrender value of life insurance	1,141.25	
Fixed assets (net increase)	15,142.50	
Patents	20,000.00	
Prepaid expense	2,452.03	163,122.42
Payments of serial-bond maturities		10,000.00
Reduction in current liabilities		6,484.43
		$242,448.85

Examination, May, 1958

EXAMINATION IN ACCOUNTING PRACTICE—PART I

May 14, 1958; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—20 to 35 minutes)

X and Y operated a restaurant in New York City as equal partners. They leased the building at a monthly rental of $300, beginning January 1, 1957 and ending December 31, 1966.

Their books of account disclosed the following information for the year 1957:

Sales		$95,000
Dividends on A Corp. Common Stock		100
Gain on sale of A Corp. Common Stock:		
Sold 8/15/57	$4,700	
Cost 1/4/57	4,000	700
Advertising expense		5,000
Insurance (annual renewal)		150
Laundry		1,500
Legal and audit		1,200
Licenses and taxes		300
Printing		1,000
Repairs and maintenance		2,700
Rent		3,600
Utilities		1,200
Salaries and wages		35,000
Miscellaneous expense		1,200
Purchase of tables, chairs, and rugs		8,000
Purchase of heavy kitchen equipment, including stoves, refrigerators, etc.		12,000
Purchase of dishes		2,000
Leasehold improvements		3,500
Food purchases		30,000
Contribution to Red Cross		300
Contribution to National League of Women Voters		2,000
Loss on sale of B Corp. Common Stock:		
Sold 11/17/57	3,000	
Cost 9/5/57	3,200	200

Each of the partners devoted full time to the business and withdrew $75 per week during the taxable year which is not included above. Profits and losses were shared equally.

The following year-end adjustments should be considered:

The furniture and appliances were estimated to have a 10-year life. The leasehold improvements have an expected useful life of 17½ years. Assume a full year in 1957. Dishes worth $1,500 were on hand on December 31, 1957. There was a $400 food inventory at the end of the taxable year.

This problem relates to U. S. Income Tax and should be answered in accordance with the Internal Revenue Code of 1954.

You are to prepare in good form:

a. A schedule of ordinary income for the partnership.
b. A schedule showing each partner's share of income credits and deductions (Schedule K).

Number 2 (Estimated time—50 to 75 minutes)

The Adams-Story Partnership of which Adams is manager has had difficulty in meeting its obligations as the debts matured. If the business is dissolved it will require six months. The bookkeeper prepared the following trial balance.

ADAMS-STORY PARTNERSHIP
Trial Balance
April 15, 1958

Cash in banks	$ 20,000	
Accounts receivable	100,000	
Allowance for bad debts		$ 4,000
Notes receivable	58,000	
Notes receivable discounted		12,000
Raw materials	9,000	
Work in process	20,000	
Finished goods	15,000	
Prepaid insurance	1,200	
Property held in trust	18,000	
Machinery and equipment, cost	9,000	
Building	33,000	
Land	12,000	
Accumulated depreciation		6,000
Interest receivable	700	
Payroll taxes payable		200
Real estate taxes		1,200
Wages payable		3,450
Notes payable		60,000
Accounts payable		125,700
Mortgage payable—4%		40,000
Equipment contract payable (purchased on a conditional sales contract)		6,400
Interest payable		1,000
Adams, capital		15,975
Story, capital		1,975
Trust principal		18,000
	$295,900	$295,900

An analysis of the accounts revealed the following:

(a) Cash in First Bank, $8,000; in Second Bank, $12,000.

(b) Of the accounts receivable, 60% are good and fully collectible, 30% are doubtful and considered to be only 80% collectible, the remaining 10% are worthless.

(c) All notes are good and are pledged as security on notes payable to the Factor House of $50,000 with accrued interest of $500.

(d) Of the notes which were discounted at the Manning Bank it is estimated that one, amounting to $2,000, will not be paid at maturity or thereafter.

(e) All finished goods will be sold for 20% less than their cost. Work in process cannot be sold until finished and can be completed by incurring labor and material costs of $9,000 of which $3,000 will be from raw material inventory. The balance of the raw material inventory will realize $5,000.

(f) The prepaid insurance which expires October 15 has a short-term cancellation value on April 15 of $900.

(g) Property held in trust is in the form of stocks and bonds with realizable value of $24,000. The partnership is entitled to a fee of $600 per year, payable April 15, for their services. Cash was not available in the trust for the payment, therefore the fee was not recorded.

(h) The machinery and equipment with a book value of $8,000 will realize $5,000.

(i) The land and building may be sold for $38,000, however the mortgage holder has indicated a willingness to cancel the debt and assume all encumbrances for the surrender of title to the real estate. Interest on the mortgage was paid on January 15.

(j) The wages and commissions were last paid in full on December 31. Commission salesmen were dismissed on February 15. Accrued wages in the trial balance are:

Burke, bookkeeper (to April 15)	$1,400
Commission salesman (to February 15)	300
Adams, manager (to April 15)	1,750
	$3,450

(k) The partnership owes the Second Bank a note of $10,000.

(l) The estimated administrative expenses are $3,000.

(m) While Adams has personal liabilities which are approximately equal to his personal assets, Story's personal assets exceed his personal liabilities by $2,800.

You are required to prepare:

a. A statement in good form showing the estimated deficiency, if any, to unsecured creditors, and
b. A statement showing the estimated amounts available for each class of creditors.

Number 3 (Estimated time—70 to 100 minutes)

A client submits the following details about The Appliance Business to be formed:

Estimated sales in terms of units by months:

January	100
February	160
March	180
April	220
May	380
June	360

Each appliance will be sold for $200. It is anticipated that 25% will be sold for cash and the balance on an installment contract. The installment contract requires a down payment of 10% and ten monthly payments of $20 each which include the finance charge. The finance charge is assumed to be earned in proportion to the collections on installment contracts.

The appliances cost $125 each. Their purchase can be financed by paying 20% down with a non-interest bearing floor-plan note for the balance. This balance must be paid at the end of the month in which the appliance is sold. An average inventory of 200 units should be maintained. The same purchase terms will be available for all replacements.

The installment contracts will be pledged as collateral for loans of 60% of the unpaid balance. These loans will be reduced, monthly, by 60% of all installment collections received. The client agrees to maintain a minimum bank balance of $15,000.

Salesmen will be allowed a commission of $20 per unit to be paid the month of the sale. Other variable expenses will be approximately $30 per unit sold. Other fixed expenses are estimated at $1,200 per month. Interest expense on bank loans will be 6% per annum on loans outstanding at the end of the previous month.

Assume that payments to the manufacturer and monthly advances from the bank will be consummated on the last day of each month. Bank interest will be payable monthly following the date the loan is received. For budgeting purposes all computations should be to the nearest ten dollars.

From the foregoing information you are to prepare a cash budget by months, with appropriate supporting schedules, which will summarize cash receipts, cash disbursements, and additional cash investments required to comply with the terms of the bank loan.

GROUP II

(Estimated time—40 to 60 minutes)

(Answer only one question in this group. If both are answered, only the first will be considered.)

Number 4

The City of Bergen entered into the following transactions during the year 1957:

(1) A bond issue was authorized by vote to provide funds for the construction of a new municipal building which it was estimated would cost $500,000. The bonds were to be paid in ten equal installments from a sinking fund, payments be-

ing due March 1 of each year. Any balance of the bond fund is to be transferred directly to the sinking fund.

(2) An advance of $40,000 was received from the General Fund to underwrite a deposit on the land contract of $60,000. The deposit was made.

(3) Bonds of $450,000 were sold for cash at 102. It was decided not to sell all of the bonds because the cost of the land was less than was expected.

(4) Contracts amounting to $390,000 were let to Michela and Company, the lowest bidder, for the construction of the municipal building.

(5) The temporary advance from the General Fund was repaid and the balance on the land contract was paid.

(6) Based on the architect's certificate, warrants were issued for $320,000 for the work completed to date.

(7) Warrants paid in cash by the treasurer amounted to $310,000.

(8) Due to changes in the plans the contract with Michela and Company was revised to $440,000; the remainder of the bonds were sold at 101.

(9) Before the end of the year the building had been completed and additional warrants amounting to $115,000 were issued to the contractor in final payment for the work. All warrants were paid by the treasurer.

Required:

a. Record the above and closing entries in bond fund T-accounts. Designate the entries in the T-accounts by the numbers which identify the data.

b. Prepare applicable fund balance sheets as of December 31, 1957, considering only the proceeds and expenditures from bond fund transactions.

Number 5

A corporation's only business is the ownership and operation of a large office building on leased land. The lease will expire, and the building will become fully amortized, in five years. The building is in excellent condition and fully occupied at favorable rental rates. There has been considerable appreciation in the value of the property. Since depreciation is based on costs of forty years ago, the date of construction of the building, the corporation's taxable income is unusually large. Corporate management believes that the building and balance of the leasehold could be sold at a price which would effect a substantial tax advantage to the corporation while still leaving a profitable operation to the buyer for the balance of the five years. There has been only slight variation in profits for each of the past five years.

Average of Profit and Loss Statements

Rental Income		$1,000,000
Expenses:		
Operations	$300,000	
Administration	50,000	
Property taxes	50,000	
Depreciation (straight line)	100,000	500,000
Net income before taxes		$ 500,000
Income taxes—52%		260,000
Net income after taxes		$ 240,000

You are to indicate a proper range of bargaining as to price, based on the average of profit and loss statements assuming no change in income, expense, or tax rates. The sale, if made, would be a cash sale. Ignore any possible relationship between buyer and seller and any residual value of furnishings at the expiration of the lease. Ignore interest or discount, alternative uses of the funds by either the buyer or the seller, or any other variables.

a. What is the least the seller could take?

b. What is the most the buyer could pay?

EXAMINATION IN ACCOUNTING PRACTICE—PART II

May 15, 1958; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—30 to 50 minutes)

From the following information set forth below you are to prepare a Federal income tax return for Mr. Bernard Dooley for the calendar year 1957. Your solution should show in schedule form all items going into the computation of the net taxable income, the computation of the tax and the final balance payable or overpayment of tax. Set up in good form any supporting computations needed in preparation of the return.

Bernard Dooley, age 43, maintains a home in which he supports his daughter, age 4. Ann, age 40, the wife of Dooley, died on October 27 of the current year. On November 1, Dooley employed a woman who spent one-half her time as housekeeper and one-half as baby-sitter at a salary of $50 per month plus board and room. The cost of the board and room is estimated to be $100 a month.

Dooley earned $7,500, before withholdings, from Zinc Smelter, Inc. Income taxes of $980 and FICA taxes of $94.50 were withheld from his wages. In connection with his work he incurred $450 in business transportation expenses which were not reimbursed. During the year he paid $300 on account of his declaration of estimated tax for 1957.

On December 1, 1957 he sold 100 shares of Essel Stock for net proceeds of $20,930. The stock was acquired on January 15, 1957 for $16,000.

Dooley and his wife jointly owned $2,500 cost and face value of U. S. Treasury Bonds issued December 27, 1940 on which interest of $50 was collected during the year. Interest of $60 was received on T-T & Z bonds, a corporation chartered in the U. S., and $245 interest on savings bank deposits was credited to his account.

On common stock of CBC, a domestic corporation, cash dividends of $200 were received after July 31, 1957 by Dooley; his wife received a dividend of $300 from the same corporation.

On October 1, 1957 he received a gift of C. U. stock, a U. S. industrial corporation, with a fair market value of $12,000, from his uncle. This stock had been purchased by his uncle on February 2, 1948 for $10,000. On November 18 all this stock was sold for net proceeds of $10,960.

On August 20, 1957 information was received about the death of a friend who owed $2,400 to Dooley. The friend had no estate from which the loan can be paid.

On November 20, 1957 the face value of $4,000 on a life insurance policy on his wife's life was received. The total premiums which had been paid amounted to $2,200.

During the year $1,200 from rental of a house owned by Dooley was received. Depreciation and out-of-pocket current expenses including real estate taxes amounted to $1,400 on the house.

During the taxable year he spent $1,200 for entertainment in connection with his employer's business. On December 30, 1957 he received a check for $2,000 from his employer to cover such entertainment expenses.

Personal expenses paid during the year included:	
Property tax on residence	$ 330
Federal excise taxes	30
State sales and use taxes	80
Contributions to the C-P Church	2,000
Contributions to community chest	100
Contribution to the Republican Political Party Central Committee	200
Prescribed drugs and medicines purchased	160
Doctor bills paid, total	820
Settlement from health and hospitalization policy	400
Dental bills paid	50
Health and hospitalization insurance premiums	150
Payment to CPA for the preparation of tax return	60

In October his personal automobile was involved in an accident in which the loss in fair market value amounted to $900, however his recovery from his automobile insurance was $850. The insurance premium on the automobile was $120.

Tax Rate Tables

	Single Persons	*Heads of Households*
$ 0 to $ 2,000	20%	20%
2,000 to 4,000	$ 400 plus 22%	$ 400 plus 21%
4,000 to 6,000	840 plus 26%	820 plus 24%
6,000 to 8,000	1,360 plus 30%	1,300 plus 26%
8,000 to 10,000	1,960 plus 34%	1,820 plus 30%
10,000 to 12,000	2,640 plus 38%	2,420 plus 32%
12,000 to 14,000	3,400 plus 43%	3,060 plus 36%

	Married Taxpayers Filing Joint Returns
$ 0 to $ 4,000	20%
4,000 to 8,000	$ 800 plus 22%
8,000 to 12,000	1,680 plus 26%
12,000 to 16,000	2,720 plus 30%

Number 2 (Estimated time—60 to 80 minutes)

You have been asked by a client to review the records of the Ranmill Manufacturing Company, a small manufacturer of precision tools and machines. Your client is interested in buying the business and arrangement have been made for you to review the accounting records.

Your examination reveals the following:

1. The Ranmill Manufacturing Company commenced business on April 1, 1955 and has been reporting on a fiscal year ending March 31. The company has never been audited, but the annual statements prepared by the bookkeeper reflect the following income before closing and before deducting income taxes:

Year Ended March 31	*Net Income Before Taxes*
1956	$37,800
1957	56,200
1958	53,790

2. A relatively small number of machines has been shipped on consignment. These transactions have been recorded as an ordinary sale and billed as such. On March 31 of each year, machines billed and in the hands of consignees amounted to:

1956	$6,110
1957	none
1958	5,343

Sales price was determined by adding 30% to cost.

3. On March 30, 1957, two machines were shipped to a customer on a c.o.d. basis. The sale was not entered until April 5, 1957, when cash was received in the amount of $5,800. The machines were not included in the inventory at March 31, 1957.

4. All machines are sold subject to a five-year warranty. It is estimated that the expense ultimately to be incurred in connection with the warranty will amount to ½ of one per cent of sales. The company has charged an expense account for warranty costs incurred.

Sales per books and warranty costs were:

Year Ended March 31	*Sales*	*Warranty Expense for Sales Made In* 1956	1957	1958	*Total*
1956	$ 844,710	$680			$ 680
1957	905,000	320	$1,170		1,490
1958	1,604,110	290	1,450	$1,710	3,450

5. A review of the corporate minutes reveals the manager is entitled to a bonus of ½ of one per cent of the net income before deducting income taxes and his bonus. The bonuses have never been recorded or paid.

6. Bad debts have been recorded on a direct write-off basis. Experience of similar enterprises indicates that losses will approximate ¼ of one per cent of sales. Bad debts written off were:

	Bad Debts Incurred on Sales Made in 1956	1957	1958	*Total*
1956	$670			$ 670
1957	720	$ 480		1,200
1958	200	1,700	$1,500	3,400

7. The bank deducts 6% on all contracts financed. Of this amount ½% is placed in a reserve to the credit of the Ranmill Manufacturing Company which is refunded to Ranmill as finance contracts are paid in full. The reserve established by the bank has not been reflected in the books of Ranmill. The

excess of credits over debits (net increase) to the reserve account with Ranmill on the books of the bank for each fiscal year were as follows:

1956	$ 2,800
1957	3,750
1958	4,960
	$11,510

8. Commissions on sales have been entered when paid. Commissions payable on March 31 of each year were:

1956	$ 1,200
1957	700
1958	960

9. On May 17, 1957, the building was sold to an insurance company for $890,000. Its book value at the date of sale was $880,000.

a. Present a schedule showing the revised net income before income taxes for each of the years ended March 31, 1956, 1957, and 1958. Make computations to the nearest whole dollar.
b. Prepare the journal entry or entries you would present the bookkeeper to correct the books. Assume the books have not yet been closed for the fiscal year ended March 31, 1958. Disregard correction of income taxes.
c. Compute the purchase price. Your client will pay the amount of the corrected book value of the net assets at March 31, 1958 plus goodwill equal to two times the average profits before taxes in excess of a 6% return on the final capital. According to the books the net assets were $548,250 at March 31, 1958. Extraneous gains and losses are not to be considered in the calculation of average annual profits.

Number 3 (Estimated time—30 to 50 minutes)

Blank and Company is a family partnership engaged in the wholesale trade. It closes its books at December 31. During the year, all transactions are recorded on a cash receipts and disbursements basis. However, at the end of the fiscal year, adjustment is made to what was termed the "inventory account" for all items necessary to reflect operations and financial position on an accrual basis.

Partner E died on October 31, 1957. His will left equal shares in his estate to partners A and C and an outsider, F. For purposes of this problem, assume no probate period, and that E's estate was distributed immediately. All remaining partners, together with F, agreed that the business of Blank and Company would continue as a partnership of A, B, C, D and F, with beginning interest on November 1, 1957 as computed on a proper accrual basis to October 31, and after distribution of E's interest on that date.

Depreciation of fixed assets may be ignored.

Balances as shown by the books of the firm were as follows:

	January 1, 1957	*October 31, 1957*
Cash	$ 42,000	$ 55,000
Inventory Account	195,000	195,000
Fixed Assets	60,000	59,000
Accruals	29,000	16,000
Notes Payable	100,000	60,000
Partners' Equity	168,000	168,000
Sales	—	2,000,000
Purchases	—	1,725,000
Operating Expenses	—	210,000

In addition to the above, the following information concerning the inventory account was available.

At January 1, 1957: Accounts Receivable, $80,000; Merchandise, $200,000; Freight Claims (on incoming merchandise), $2,000; Prepaid Operating Expenses, $10,000; Accounts Payable, $90,000; Allowances Due Customers, $7,000. At October 31, 1957: Accounts Receivable, $83,300; Merchandise, $221,000; Freight Claims (on incoming merchandise), $1,500; Prepaid Operating Expenses, $6,000; Accounts Payable, $85,000; Allowances Due Customers, $8,000.

Partners' equities and profit-and-loss sharing ratio:	*Equities*	*Profit and Loss Ratio*
A	$ 10,500	6.25%
B	52,500	31.25%
C	77,000	37.50%
D	7,000	12.50%
E	21,000	12.50%
	$168,000	100.00%

You are to prepare in good form:

a. An income statement for the period January 1 to October 31.

b. A statement of financial position at October 31.

c. A statement of partners' equities on November 1.

GROUP II

(Estimated time—60 to 90 minutes)

(Answer only one question in this group. If both are answered, only the first will be considered.)

Number 4

You have been requested to audit the accounts of Boulevard Homes, Inc., as at December 31, 1957, and prepare financial statements from the following trial balance:

		Debit	Credit
Cash		$ 43,500	
Properties			
Costs:			
Land	$ 40,000		
Improvements—Clearing	30,000		
Improvements—Grading and streets	280,000		
Construction contract	680,000		
Miscellaneous costs (taxes, insurance, etc., all applicable to house construction)	30,000		
		1,060,000	
Sales			$ 453,500
Notes payable to bank			400,000
Notes payable to stockholders			200,000
Capital stock			50,000
		$1,103,500	$1,103,500

During your examination the following information is obtained:

The company constructed 40 houses during 1957. Clearing, grading and street work was performed by the company. Construction of the houses was completed by October 31. During November and December, 25 houses were sold as follows:

1 @ $15,000	$ 15,000
13 @ 17,500	227,500
5 @ 19,000	95,000
6 @ 20,000	120,000
	$457,500
Less title insurance and recording fees	4,000
	$453,500

It is planned to sell the remaining 15 houses at the following selling prices:

3 @ $15,000	$ 45,000
7 @ 17,500	122,500
5 @ 19,000	95,000
	$262,500

Additional costs to sell (including title insurance and recording fees) are estimated at 5% of selling prices.

Charges amounting to $5,000 included in Improvements—grading and streets, and charges of $1,500 included in Miscellaneous costs represent interest on bank loans, salesmen's salaries and expenses applicable to the two months after completion of construction.

Additional costs, unpaid and not recorded at December 31, were:

Balance due on construction contract	$12,000
Liability insurance for period ending October 31	3,500
Salesmen's salaries and expenses for December	1,500
	$17,000

It was learned that the wood flumes installed as street sewers must be replaced with steel pipe at an estimated cost of $19,000.

Land purchased was plotted into 200 lots, of which 70 were subsequently improved by the company (with grading and streets). Approximately one-half of the land was cleared, and houses were erected on 40 of the 70 lots. The costs associated with the land and the construction of houses were considered to be proportional to the sales prices on the houses.

Required:

a. Adjusting journal entries supported by schedules prepared in good form.

b. A balance sheet.

c. A profit and loss statement.

Number 5

The Smith Company uses a standard cost system. The standards are based on a budget for operations at the rate of production anticipated for the current period. The Company records in its general ledger, variations in material prices and usage, wage rates and labor efficiency. The accounts for manufacturing expenses reflect variations in activity from the projected rate of operations, variations of actual expenses from amounts budgeted, and variations in the efficiency of production.

Current standards are as follows:

Materials:	
Material A	$1.20 per unit
Material B	2.60 per unit
Direct labor	$2.05 per hour

	Special Widgets	*De Luxe Widgets*
Finished products (content of each unit):		
Material A	12 units	12 units
Material B	6 units	8 units
Direct labor	14 hours	20 hours

The general ledger does not include a finished goods inventory account; costs are transferred directly from work in process to cost of sales at the time finished products are sold.

The budget and operating data for the month of August, 1957 are summarized as follows:

Budget:		
Projected direct labor hours	(hours)	9,000
Fixed manufacturing expense		$ 4,500
Variable manufacturing expenses		13,500
Selling expenses		4,000
Administrative expenses		7,500

Operating data:

Sales:

500 special widgets		$52,700
100 de luxe widgets		16,400

Purchases:

Material A	8,500 units	$ 9,725
Material B	1,800 units	5,635

Material requisitions:	*Material A*	*Material B*
Issued from stores:		
Standard quantity	8,400 units	3,200 units
Over standard	400 units	150 units
Returned to stores	75 units	

Direct labor hours:

Standard	9,600 hours
Actual	10,000 hours

Wages paid:

500 hours at	$2.10
8,000 hours at	2.00
1,500 hours at	1.90

Expenses:

Manufacturing	$20,125
Selling	3,250
Administrative	6,460

Required:

a. Prepare journal entries to record operations for the month of August, 1957. Show computations of the amounts used in each journal entry. Raw material purchases are recorded at standard.

b. Prepare a statement of profit and loss for the month supported by an analysis of variations.

EXAMINATION IN AUDITING

May 15, 1958; 9 a.m. to 12:30 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—30 to 40 minutes)

You have been assigned to the first examination of the accounts of The Chicago Company for the year ending March 31, 1958. The accounts receivable were circularized at December 31, 1957 and at that date the receivables consisted of approximately 200 accounts with balances totaling $956,750. Seventy-five of these accounts with balances totaling $650,725 were selected for circularization. All but 20 of the confirmation requests have been returned; 30 were signed without comments, 14 had minor differences which have been cleared satisfactorily while 11 confirmations had the following comments:

a. We are sorry but we cannot answer your request for confirmation of our account as the PDQ Company uses an accounts payable voucher system.

b. The balance of $1,050 was paid on December 23, 1957.

c. The above balance of $7,750 was paid on January 5, 1958.

d. The above balance has been paid.

e. We do not owe you anything at December 31, 1957 as the goods, represented by your invoice dated December 30, 1957, number 25,050, in the amount of $11,550, were received on January 5, 1958 on FOB destination terms.

f. An advance payment of $2,500 made by us in November 1957 should cover the two invoices totaling $1,350 shown on the statement attached.

g. We never received these goods.

h. We are contesting the propriety of this $12,525 charge. We think the charge is excessive.

i. Amount okay. As the goods have been shipped to us on consignment we will remit payment upon selling the goods.

j. The $10,000, representing a deposit under a lease, will be applied against the rent due to us during 1960, the last year of the lease.

k. Your credit dated December 5, 1957 in the amount of $440 cancels the above balance.

What steps would you take to clear satisfactorily each of the above eleven comments?

Number 2 (Estimated time—27 to 37 minutes)

Prepare an audit program which would bring to light various types of contingent liabilities and commitments. (The program should be in general terms for each area covered and should describe briefly the type of contingent item which might be found under each step. Ignore the fact that several of the steps in the program might normally be included in programs for other parts of your examination.)

Number 3 (Estimated time—27 to 37 minutes)

a. What are the auditor's responsibilities and duties in an examination of financial statements with respect to his client's fire insurance coverage? (Do not consider an analysis of prepaid insurance premiums.)

b. You are engaged in an audit of the Schmidt Corporation for the year ending December 31, 1957. The client has asked for a special report on the company's insurance program, which is to include a "schedule of expected recovery," assuming a 50% fire loss on each insurable asset as of the audit date. During the course of your examination you gather the following information in this connection:

	Book Value	*Fire Insurance Coverage*	*Certified Appraised Value*	*Co-insurance Requirement*
Inventory	$200,000	$180,000	$218,000	—0—
Furniture and fixtures, net	40,000	28,000	35,000	80%
Machinery and equipment, net	99,200	90,000	*	90%
Building, net	200,000		200,000	
Insured with: Co. X		85,000		90%
Co. Y		70,000		80%

*The machinery and equipment was purchased two years ago at a cost of $124,000. The certified appraisal report, dated December 29, 1957, indicated a replacement cost, new, of $150,000 and a remaining life of ten years.

You are to prepare the audit working paper, complete in all details, containing the above information, which would appear in your working paper files, and from which the "schedule of expected recovery" to be included in the special insurance report to the client will be prepared.

GROUP II

(Estimated time—66 to 96 minutes)

(Answer any three questions in this group. If more are answered, only the first three will be considered.)

Number 4

Discuss briefly what you regard as the more important deficiencies in the system of internal control in the following situation, and in addition include what you consider to be a proper remedy for each deficiency:

The cashier of the Easy Company intercepted customer A's check payable to the company in the amount of $500 and deposited it in a bank account which was part of the company petty cash fund, of which he was custodian. He then drew a $500 check on the petty cash fund bank account payable to himself, signed it and cashed it. At the end of the month while processing the monthly statements to customers, he was able to change the statement to customer A so as to show that A had received credit for the $500 check that had been intercepted. Ten days later he made an entry in the cash received book which purported to record receipt of a remittance of $500 from customer A, thus restoring A's account to its proper balance, but overstating cash in bank. He covered the overstatement by omitting from the list of outstanding checks in the bank reconcilement, two checks, the aggregate amount of which was $500.

Number 5

The assets of The Mens' Custom Shop at May 31, 1957 are listed below:

Assets	*Amount*
Cash	$ 60,000
Accounts receivable (net)	190,000
Merchandise inventory	460,000
Equipment (net)	105,000
Total	$815,000

During the course of your annual examination of the company's financial statements, the owner advises you that he will not permit circularization of the accounts receivable because his customers would resent it.

a. State the conditions, if any, under which you would render an unqualified opinion on the financial statements.

b. Describe generally the major audit procedures you would use to audit the accounts receivable to satisfy yourself as to their validity considering the imposed limitation.

c. Prepare the short-form report you would render on these financial statements.

Number 6

Independent certified public accountants customarily issue two types of auditor's reports in connection with an examination of financial statements: a so-called short-form of auditor's report in connection with financial statements intended for publication; and a so-called long-form of auditor's report for the purposes of management and other parties.

a. Outline in general terms the kinds of materials which are commonly included in a long-form report other than those commonly included in a short-form report.

b. Does the auditor assume the same degree of responsibility for other data in the long-form report that he assumes for individual items in the customary basic financial statements (balance sheet and statements of income, retained income and capital)? State the reasons for your answer.

Number 7

During your first examination of the financial statements of the ABC Corporation, you find the following accounts and balances among the various other items in the trial balance:

1. Claim for refund—Federal income taxes $124,000
2. Investment in stock of XYZ Company (5,000 shares of 100,000 shares issued and outstanding, organized five years ago) $500,000
3. Treasury stock—at cost $110,000

Assuming that each of these three accounts is material in relation to the total assets of the company, select any two of them and state for each:

a. The audit procedures you would apply to each of them.
b. How you would present each of the two selected in part (a) in the balance sheet to accompany your short-form audit report. (Assume that you were able to satisfy yourself as to the carrying value.)

EXAMINATION IN COMMERCIAL LAW

May 16, 1958; 9 a.m. to 12:30 p.m.

GROUP I

(Answer all five questions in this group)

Number 1 (Estimated time—15 to 20 minutes)

a. What facts are essential before an alleged corporation can be held to be a de facto corporation?

b. If any of these necessary elements is absent, what is (1) the legal status of the enterprise, (2) who has liability for its financial obligations, and (3) what is the particular nature of such liability?

c. Under what circumstances may stockholders compel directors to declare a dividend?

Number 2 (Estimated time—15 to 20 minutes)

a. Ordinarily the receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner. State five situations in which the receipt of a share of the profits of a business does not warrant the inference that the recipient is a partner.

b. Absalom Irvingon becomes a general partner in an already existing partnership. On an indebtedness owing by the firm which was incurred prior to Irvingon's admission, a creditor brings suit against the partnership and obtains judgment. Execution is issued against the partners jointly, including Irvingon, and the judgment creditor seeks to enforce it against Irvingon. Assuming it to be enforceable against Irvingon, who is solvent, what assets and property of Irvingon are subject to the execution? Explain.

Number 3 (Estimated time—20 to 26 minutes)

a. Alcott, knowing there is no such person as Prester John, makes out and signs a promissory note payable to the order of Prester John. Alcott delivers it by hand to Blair. Blair, in turn, delivers it to Cadwell without indorsement. At maturity Cadwell presents the note for payment. Can Cadwell collect from Alcott? Explain.

b. (1) What is an *indorsement in blank?*
   (2) What is a *special indorsement?*
   (3) How does each *affect the negotiability* of a promissory note?

c. What is the proper place for presentment for payment of a specific instrument when no place of payment is indicated in the instrument? Explain.

Number 4 (Estimated time—20 to 27 minutes)

a. Grimm checked a bag in the parcel room of the S.L.O. railroad station at Slick City. On paying a fee of $1.00, he was given a receipt which he did not read. It contained a limitation of the railroad's liability to $25 unless an excess valuation had been declared and an additional fee paid. A posted sign to the same effect, which appeared in the parcel room, was not seen by Grimm. The following day Grimm presented his receipt but the bailee was unable to locate and return the bag. Grimm sued for $200 and proved this to be the value of the bag's contents. The S.L.O. railroad claimed that, according to the terms of the receipt, its liability was for $25 only despite Grimm's testimony that he had not read the receipt or the posted sign.
How much can Grimm recover? Explain fully.

b. Meriwether parked his car with Bleak, operator and owner of a licensed parking lot, and paid the requisite minimum charge in advance. Signs on the premises, which Meriwether read before paying the fee, stated clearly that Bleak disclaimed all liability for damage or loss with respect to parked cars no matter how caused. Bleak repeated the disclaimer to Meriwether personally and it was also stated in the receipt given. Upon Meriwether's return later to get his car, he found it had been seriously damaged through gross negligence attributable to Bleak. Bleak refused to accept responsibility for the damage and Meriwether brought suit to recover damages.
(1) What was Bleak's responsibility as to the exercise of care? Explain.
(2) Did the disclaimer relieve Bleak from all responsibility to exercise the appropriate degree of care? Explain.

Number 5 (Estimated time—20 to 27 minutes)

a. When a person negotiates or transfers a document of title for value by indorsement or delivery, what warranties is he deemed to have made unless a contrary intention appears?

b. As to an unpaid seller's right to stop goods in transit if the buyer becomes insolvent, when part delivery has already been made to the buyer may the remainder of the goods be stopped in transit? Explain.

c. Adkins had two lots of canned goods for sale at $1,500 per lot. Perkins entered into a written agreement with Adkins to purchase one lot and agreed to pay $1,500 for it in personal property consisting of linens acceptable to Adkins at a valuation of $1,500. Chester entered into a written agreement with Adkins to purchase the other lot and agreed to pay $1,500 for it in real estate consisting of a piece of land valued by Adkins at $1,500 which was to be transferred to him.
(1) Does the transaction between Adkins and Perkins come within the scope of the *Uniform Sales Act?* Explain fully.
(2) Does the transaction between Adkins and Chester come within the scope of the *Uniform Sales Act?* Explain fully.

GROUP II

(Estimated time—60 to 90 minutes)

(Answer only three questions out of five in this group. If more are answered, only the first three will be considered.)

Number 6

Barber, wishing to start a business of his own, borrowed necessary funds of $3,000 from Platt. He agreed to repay in one payment two years later. The entire agreement was oral. When payment fell due, Barber refused to pay. Platt sued for breach of contract.

a. Has Barber a legal defense to this suit? Explain.

b. Can Platt recover against Barber in any form of action other than breach of contract? What would be the measure of recovery, if any? Explain.

Number 7

a. Smith, on reaching age 65, retired in 1956 and became entitled to Federal old age insurance benefits of $75 a month. During the taxable year 1957 he returned to work in the months of March, April, September and October and earned $600 for each month's work, making a total of $2,400 for the four months. He did not engage in self-employment, or render services for wages amounting to more than $80 a month, in any of the other eight months. What amount of old age insurance benefits, if any, was Smith entitled to in the year 1957? Explain.

b. Black, on reaching age 65, retired in 1956 and became entitled to Federal old age insurance benefits of $70 a month. During the taxable year 1957 he worked throughout the entire year for wages at $110 a month, making total earnings for him of $1,320 for the year. What amount of old age insurance benefits, if any, was he entitled to for the year 1957? Explain.

Number 8

a. Mann, employed as a general mechanic by the Eureka Corporation, while working for his employer at a routine task during usual working hours and for the agreed rate of compensation, and while using raw material and machinery belonging to the employer, discovers a new and valuable method of performing a certain operation. Mann claims exclusive right to the process. The Eureka Corporation, recognizing that Mann has a property right, claims that subject to Mann's ownership right it has a special right of user in the new process which Mann cannot defeat.

What right, if any, has the Eureka Corporation as to the new process? Explain.

b. What is a *del credere* agent?

c. When items are bought and sold at auctions, (1) for whom does the auctioneer act as agent, and (2) what basic liability does his agency impose upon those for whom he acts?

d. If an agent acting for an undisclosed principal incurs personal liability to a third party in so acting, has the principal any responsibility to the agent for any loss thereby sustained by the latter? Explain.

Number 9

a. Cassidy and Randolph executed a written agreement whereby Cassidy leased certain premises to Randolph for a term of years. Randolph, upon receiving the lease, intentionally, and without the knowledge and consent of Cassidy, altered the lease by erasing his name as lessee and substituting that of Prentice. Cassidy, learning of the alteration, considered that it discharged him from any obligations under the lease to Randolph and executed another lease to Wolf as lessee.

   Did the alteration by Randolph discharge Cassidy from his obligations under the lease to Randolph and invalidate that instrument? Explain.

b. Assume a similar lease, as in (a), executed by Cassidy with Randolph as lessee. Randolph, proceeding to enter into possession was denied entry by Cassidy because Prentice, into whose hands the lease came by accident, had altered same, without the knowledge or consent of Cassidy or Randolph, by erasing the name of Randolph as lessee and substituting his own. Randolph began action under his lease against Cassidy who maintained that the alteration by Prentice had discharged Cassidy from any obligations to Randolph and had invalidated the lease.

   Did the alteration made by Prentice discharge Cassidy or Randolph from their obligations under the lease and invalidate that instrument? Explain.

c. Assume a similar lease, as in (a), executed by Cassidy with Randolph as lessee. Prentice approached Randolph after the latter had entered into possession and sought to secure from Randolph for valid consideration a legal right to occupancy of all of the leased premises for the full period of the lease or to occupancy of all or part of the leased premises for a portion of the lease period.

   Under what conditions could legal occupancy be given by Randolph and obtained by Prentice under valid agreement without discharging Cassidy's obligations under the lease to Randolph, or rendering such lease invalid? Explain fully, including the responsibility of Prentice and Randolph as to Cassidy.

Number 10

a. With respect to an indebtedness, what is an *absolute* (*unconditional*) *guaranty,* and what is the nature of the liability assumed by the guarantor?

b. In the case of an *absolute* (*unconditional*) *guaranty,* is it necessary for the creditor to give notice of the debtor's default to the guarantor before resort to the latter? Explain.

c. In a case of suretyship, what right, if any, has the creditor with respect to collateral security given by the debtor to his surety prior to the debtor's default? Explain.

EXAMINATION IN THEORY OF ACCOUNTS

May 16, 1958; 1:30 to 5:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—20 to 30 minutes)

Once equipment has been installed and placed in operation, subsequent expenditures *relating to this equipment* are frequently thought of as being in the nature of a repair or general maintenance, and hence chargeable to operations in the period in which the expenditure is made. Actually, determination of whether such an expenditure should be either charged to operations or capitalized involves a much more careful analysis of the character of the expenditure.

What are the factors that should be considered in making such a decision? Discuss fully.

Number 2 (Estimated time—20 to 30 minutes)

On January 1, 1958 Corporation Z acquired all of the outstanding stock of Corporation M in order to combine the two businesses. Z issued $100,000 par value of its stock (which had a market value of $300,000) to the stockholders of M in exchange for their stock. Immediately upon the exchange of the stock, Corporation M was dissolved and Z took over the net assets. As of January 1, 1958 Corporation M had $100,000 of stock outstanding; $100,000 of paid-in surplus; and $100,000 of retained earnings.

a. Give two ways that these transactions may be recorded on the books of Corporation Z.
b. State the circumstances under which each of the two treatments would be appropriate and give the reasoning supporting each treatment.

Number 3 (Estimated time—20 to 30 minutes)

The general manager of the Cumberland Manufacturing Company received an income statement from his controller. The statement covered the calendar year 1957. "Joe," he said to the controller, "this statement indicates that a net income of two million dollars was earned last year. You know the value of the company is not that much more than it was this time last year."

"You're probably right," replied the controller. "You see, there are factors in accounting which sometimes keep reported operating results from reflecting the change in the value of the company."

Prepare a detailed explanation of the accounting conventions to which the controller referred. Include justification, to the extent possible, for the generally used accounting methods.

Number 4 (Estimated time—20 to 30 minutes)

In a manufacturing company in which transfers of products from one department to another are made, often the charge to the receiving department is made at a figure in excess of cost to the producing department.

a. Why is this practice followed? Explain.

b. Indicate two methods of adjusting interdepartmental profits so that generally accepted reports may be prepared, and explain the necessity for the methods you suggest.

GROUP II

(Estimated time—60 to 90 minutes)

(Answer any three questions in this group. If more are answered, only the first three will be considered.)

Number 5

On September 1, 1957, the ABC Co. entered into an agreement with the X Co., whereby the X Co. was to construct a building to be leased to the ABC Co. for a ten-year period. The lease provided for annual payments in advance of $12,000 per year. The building was to be completed on March 1, 1958, at which time the first annual payment was due and the ten-year period started.

The building was not completed until March 15, 1958 when the ABC Co. moved in. Because of the delay in completion and consequent additional expense and loss of revenue to ABC Co., the X Co. agreed to reduce the *first* annual payment to $11,200, which amount was paid on April 15, 1958.

On March 31, 1958, the close of its fiscal year, the ABC Co. made the following entry in its books:

Prepaid rent	$12,000	
Rent income		$ 800
Rent payable		11,200

a. Make any adjustments you consider necessary to reflect properly these facts. State your reasoning and discuss any alternatives which may be acceptable.

b. How should these details be presented and disclosed in the financial statements of the ABC Co. at March 31, 1958?

Number 6

Given below are the details pertaining to the Power Service Department.

Schedule of Horsepower-Hours

	Producing Departments		*Service Departments*	
	A	*B*	*X*	*Y*
Needed at capacity production	10,000	20,000	12,000	8,000
Used during the month of April	8,000	13,000	7,000	6,000

During the month of April the expenses of operating the Power Service Department amounted to $9,300; of this amount $2,500 were considered to be fixed costs.

a. What dollar amounts of the Power Service Department expense should be allocated to each producing and service department?

b. What are the reasons for allocating the costs of one service department to other service departments as well as to producing departments?

Number 7

The M Co., manager of an office building, is considering putting in certain concessions in the main lobby. An accounting study produces the following estimates, on an average annual basis:

Salaries		$ 7,000
Licenses and payroll taxes		200
Cost of merchandise sold:		
Beginning inventory	$ 2,000	
Purchases	40,000	
Available	42,000	
Ending inventory	2,000	40,000
Share of heat, light, etc.		500
Pro rata building depreciation		1,000
Concession advertising		100
Share of company administrative expense		400
Sales of merchandise		49,000

The investment in equipment, which would last 10 years, would be $2,000.

As an alternative, a catering company has offered to lease the space for $750 per year, for ten years, and to put in and operate the same concessions at no cost to the M Co. Heat and light are to be furnished by the office building at no additional charge.

What is your advice to the M Co.? Explain fully.

Number 8

The HIJ Company finances some of its current operations by assigning accounts receivable to a finance company. On July 1, 1957, it assigned, under guarantee, accounts amounting to $40,000, the finance company advancing to them 80% of the accounts assigned (20% of the total to be withheld until the finance company has made its full recovery), less a commission charge of ½% of the total accounts assigned.

On July 31, the HIJ Company received a statement that the finance company had collected $21,000 of these accounts, and had made an additional charge of ½% of the total accounts outstanding as of July 31, this charge to be deducted at the time of the first remittance due HIJ Company from the finance company. On August 31, 1957, the HIJ Company received a second statement from the finance company, together with a check for the amount due. The statement indicated that the finance company had collected an additional $16,000 and had made a further charge of ½% of the balance outstanding as of August 31.

a. Make all entries on the books of the HIJ Company that are involved in the above transactions.

b. Explain how these accounts should be presented in the financial statements of HIJ Company at July 31 and at August 31.

Examination, November, 1958

EXAMINATION IN ACCOUNTING PRACTICE—PART I

November 5, 1958; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—35 to 50 minutes)

Lynn and Kay, architectural designers and interior decorators, combined May 1, 1958, agreeing to share profits: Lynn, two-thirds, Kay, one-third. Lynn contributed furniture and fixtures, $3,000 and cash $2,000; Kay contributed cash, $500.

They plan to submit monthly bills and make the following arrangements with their clients:

1. The salaries of draftsmen and shopper who are paid on an hourly basis, shall be billed to clients at the hourly rate for time spent on each job, plus 125% for overhead and profit and plus 4½% for all payroll taxes.
2. Partners' time on jobs shall be billed at $10 an hour.
3. A 10% service fee shall be charged on purchases of furniture, drapes, etc., installed on the jobs. (Lynn and Kay will pay the vendors and charge their clients for these purchases but would like to have their operating statements reflect only revenue from services.)
4. There will be no service fee on taxis, telephone and other expenses identifiable to jobs and charged to clients.

Voucher register totals for May are given below:

Credits:	
Vouchers payable	$3,469
Taxes withheld—Federal income	93
Taxes withheld—FICA	27
Income from charges to jobs for partners' time	790
Total	$4,379
Debits:	
Purchases and expenses chargeable to clients	$1,615
Partners' drawings (Lynn $100, Kay $125)	225
General expenses	784
Jobs in process	
Draftsmen's salaries	940
Partners' time	790
Petty cash fund	25
Total	$4,379

The first debit column is analyzed in the voucher register as follows:

Purchases subject to 10% fee:		
Client M, Job 51	$1,210	
Client H, Job 52	320	$1,530
Expenses chargeable to clients:		
Client M 51	$ 23	
Client M 54	7	
Client H 52	19	
Client L 53	36	85
		$1,615

The client has not yet authorized them to do job M 54. The partners are confident, however, that the job will be authorized and the above expenses, as well as charges for time spent by a draftsman and Mr. Lynn on preliminary designs, will be billed and collected.

The payroll analysis is summarized below. Partners' time on jobs, charged to the jobs at $5 an hour, is summarized in the payroll analysis for convenience in posting costs to job sheets although the partners are not paid for direct time on jobs.

Job	*Secretary*	*Draftsmen*	*Lynn*	*Kay*
M 51		$312	$120	$150
H 52		276	60	115
L 53		304	65	160
M 54		48	120	
		940	$365	$425
General Expenses				
General Office	$160	40		
Idle Time		60		
Total Payroll	$160	$1,040		

Journal entries recorded depreciation on furniture and fixtures of $25 and the employer's share of Federal and State taxes of $54.

There were no cash receipts other than the original investment. The cash disbursements book shows the following totals:

Debit:	Vouchers Payable	$2,373
Credit:	Cash	2,358
Credit:	Discount on purchases	15

Required:

a. Compute billings to clients for May.

b. Prepare a worksheet showing the balance sheet, profit and loss general ledger accounts and the profit allocation at May 31, 1958. Show how you arrive at these balances by entering all May transactions on the worksheet. Use the accounts indicated in the voucher register.

Number 2 (Estimated time—65 to 100 minutes)

Trial balances as of December 31, 1957 of the Parent Company and its two subsidiaries were:

	Parent Company		Domestic Subsidiary		Mexican Subsidiary Pesos	
	Dr.	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*
Cash	$ 10,000		$ 1,500		10,000	
Accounts receivable—Trade	30,000		8,000		35,000	
Accounts receivable—Merchandise in transit to domestic subsidiary	4,000					
Inventories	20,000				83,000	
Investments at cost:						
Domestic subsidiary 900 shares acquired 12/31/56	9,000					
Foreign subsidiary 1,000 shares acquired 12/31/56	12,000					
Fixed assets	45,000		3,500		175,000	
Goodwill			2,000			
Cost of sales	300,000		15,000		300,000	
Depreciation	3,000		200		7,000	
Taxes	15,000		400		15,000	
Selling expenses	42,000		2,400		27,000	
Administrative and general expenses	35,000		2,000		18,000	
Dividends declared			1,000			
Sales—Trade		$400,000		$21,000		381,000
Sales—Domestic subsidiary		10,000				
Accounts payable—Trade		25,000				7,000
Dividend payable				1,000		
Long-term debt due 1/1/60						100,000
Reserve for depreciation		15,000		2,000		75,000
Capital stock		50,000		*10,000		*100,000
Surplus 1/1/57		25,000		2,000		7,000
	$525,000	$525,000	$36,000	$36,000	670,000	670,000

*1,000 shares issued and outstanding.

Data:

In April 1957 the Mexican peso was devalued from U. S. $.12 the prevailing rate of exchange on December 31, 1956 to $.08 which was also the prevailing rate of exchange on December 31, 1957.

Required:

a. Prepare working trial balance in U. S. dollars for the Mexican subsidiary.

b. Prepare working papers for consolidated statements.

GROUP II

(Estimated time—80 to120 minutes)

(Solve any two problems in this group. If three are solved only the first two will be considered.)

Number 3

The controller of the Jones Manufacturing Company asks for your advice and assistance regarding the problem of whether or not they should replace their "A" machines with new and advanced "B" machines. "B" machines are capable of doubling the present annual capacity of the "A" machines. At the present time the annual finished production of the "A" machines is 2,500,000 good units. You are to assume that the increased production can be sold at the same profitable price.

The "A" machines are being depreciated by the Jones Manufacturing Co. under the straight line method using a salvage value of 10% and a useful life of 8 years. The "A" machines cost the Jones Manufacturing Co. $175,000 plus freight and insurance of $25,000. The raw materials as they are fed into the machines are subject to heavy pressure; because of this there is a 20% waste factor on an annual basis. The waste materials have no value and are scrapped for nominal value. Direct labor costs are equal to 60% of prime costs at the present time (labor and materials are considered prime costs). The company has been purchasing its raw materials in small lots at a cost of $50.00 per 1,000 units. Factory overhead, exclusive of depreciation is applied to the manufacturing process at the rate of 20% of direct labor costs.

If the company purchases the "B" machines, certain economies will be gained. Material costs will decrease 20% because the company will be able to buy in larger quantities. In addition, the new machines have been perfected to such an extent that the waste factor will be reduced by 50%. However, because the "B" machine is much larger than the "A" machine, direct labor cost will be expected to increase by 20% of itself. Direct labor will continue to be 60% of prime cost before the increase of 20% in direct labor cost is applied. In addition to this, it is expected that factory overhead rate will increase by 10% of itself. The life of the new machines is expected to exceed the life of the "A" machines by ¼ and the salvage value of the "B" machines will be in the same ratio as the salvage value of the "A" machines. The cost of the "B" machines, including freight and insurance of $35,000, will amount to $500,000. The company is aware of the fact that dismantling costs and installation costs will be involved, however, they do not wish to consider this factor at the present time.

Required:

a. A statement of estimated cost comparisons on an annual basis. (Round to the nearest dollar.)

b. List additional factors that should be considered in deciding upon the replacement.

c. Comment briefly on the usefulness and validity of the comparisons made in part a.

Number 4

The audit working papers revealed the following information about the Kenby Corporation as of December 31, 1957.

	December 31, 1956	*December 31, 1957*
Inventory at retail (gross of discounts and reserves)	$1,350,675	$1,851,645
Reserve for future mark-downs, at cost (representing mark-downs not reflected on tags or stock books at closing)	125,600	150,500
Discounts included in inventory	29,040	(to be computed)
Reserve for purchase discounts	12,285	(to be computed)
Accounts payable	245,700	370,250

	Year—1957
Purchases, gross—Cost	$2,272,500
Purchases, gross—Retail	5,179,800
Purchase discounts received	135,000
Mark-up adjustments during year	378,500
Mark-downs	897,600
Mark-down cancellations included in mark-ups above	221,400

The correctly computed gross mark-on, based on sales, at December 31, 1956 was 57%.

Required:

a. Calculate the gross mark-on percent and net sales for 1957.

b. Calculate the purchase discount applicable to the December 31, 1957 inventory.

c. Calculate the inventories at the lower of cost or market to be reported on the December 31, 1956 and 1957, comparative balance sheets.

d. Prepare a schedule of gross profit on sales for the fiscal year ending December 31, 1957.

Number 5

You have been engaged as a consultant to another accountant to assist with the preparation of the federal income tax return of a small bank in a rural area.

The bank's balance sheets at December 31, 1956 and December 31, 1957 and the Undivided Profits account for the year ended December 31, 1957 appear below.

There were no unusual expenditures charged to Advertising, Repairs and Unclassified; no sales or purchases of mortgage notes requiring unusual tax treatment; no dispositions of depreciable property and the bank does not use the reserve method of accounting for bad debts.

The Town Bank
Balance Sheets
December 31, 1957

Assets	*Beginning of Taxable Year*	*End of Taxable Year*
Cash	$ 587,904	$ 467,986
Loans and discounts	1,062,327	1,192,988
Stock—Federal Reserve Bank	3,000	3,000
Banking house	13,000	20,904
Furniture and fixtures	3,000	5,000
Securities—other	419,498	444,741
U. S. Treasury Bonds	572,420	578,280
Overdrafts	488	712
	$2,661,637	$2,713,611
Liabilities		
Deposits	$2,495,637	$2,535,211
Capital stock	25,000	25,000
Surplus	75,000	75,000
Reserve for contingencies	20,000	20,000
Undivided profits	46,000	58,400
	$2,661,637	$2,713,611

The Town Bank
Undivided Profits
For the Year—1957

Item No.		*Debit*	*Credit*
	January 1—Balance		$ 46,000
1.	Interest—U. S. bonds		21,000
2.	Interest—Loans and discounts		70,000
3.	Interest—State and municipal obligations		5,000
4.	Exchange, service charges and box rentals		19,000
5.	Loan recoveries		1,000
6.	Profit on sale of bonds		100
7.	Wages and salaries	$ 43,000	
8.	Interest on savings accounts and certificates of deposit	14,000	
9.	Taxes	10,000	
10.	Advertising	2,400	
11.	Repairs	6,200	
12.	Unclassified	12,100	
13.	Bond premiums	1,600	
14.	Notes charged off	5,000	
15.	Depreciation—Furniture and fixtures	3,400	
16.	Depreciation—Building	1,000	
17.	Dividend	5,000	
	December 31—Balance	58,400	
		$162,100	$162,100

Required:

a. On the answer sheet provided, indicate by an X in the appropriate space the proper federal income tax treatment for each debit and credit appearing in the Undivided profits account. No dividend was received on the Federal Reserve Bank Stock.

b. List on a separate sheet any additional technical information required to complete the return. Key each answer by use of the item number shown in the problem.

EXAMINATION IN ACCOUNTING PRACTICE—PART II

November 6, 1958; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—10 to 20 minutes)

From the following data relative to the operation of the Happy Home Project during 1957 you are requested to prepare a schedule showing cash collections of rents for the year.

Gross potential rents	$211,688
Vacancies	42,609
Space occupied by corporation for own use	4,925
Prepaid rent:	
Beginning of period	302
End of period	984
Delinquent rent:	
Beginning of period	377
End of period	79
Deposits (tenants') forfeited	100
Refunds to tenants	20
Uncollectible rents	80

Number 2 (Estimated time—45 to 65 minutes)

You have been engaged by a client, for the second consecutive year, to perform a general audit of the Corporation's books as of June 30, 1958. You have analyzed all general ledger accounts and made the necessary adjusting entries with the exception of the balance of federal income tax liability. The account as it appears in the general ledger is transcribed as follows:

Federal Income Tax Liability—Account

Date	*Explanation*	*Folio*	*Debit*	*Credit*
7/1/57	Balance brought forward			$597,299.63
8/17/57	Bill for additional assessment Y/E 6/30/56	VR	$ 51,639.94	
9/15/57	1st half instalment of tax Y/E 6/30/57	VR	274,175.91	
9/30/57	Estimated provision for 1st quarter	JE-8		150,000.00
12/15/57	2nd half instalment of tax Y/E 6/30/57	VR	274,175.91	
12/30/57	Estimated provision for 2nd quarter	JE-8		150,000.00
3/15/58	Payment of 30% of estimated tax liability less $100,000	VR	150,000.00	
3/30/58	Estimated provision for 3rd quarter	JE-8		150,000.00
6/30/58	Estimated provision for 4th quarter	JE-8		150,000.00

The general ledger trial balance of the income and expense accounts appears below:

Account Name	*Debit*	*Credit*
Sales		$38,400,962.15
Sales allowances	$ 25,000.00	
Purchases	29,065,022.52	
Labor	6,821,258.15	
Inventory increase		150,824.13
Depreciation	595,832.28	
Local taxes	75,682.14	
Insurance	183,462.93	
Insurance on lives of officers	6,845.42	
Pension plan expense	45,000.00	
Salaries	366,805.13	
Advertising expense	98,462.48	
Interest expense	62,540.00	
Provision for federal income taxes	600,000.00	
Totals	$37,945,911.05	$38,551,786.28

Additional information:

On March 15, 1958 a declaration of estimated tax was filed. The tax was estimated to be $600,000. A payment of $150,000 was made.

The Corporation's tax return for the year ended June 30, 1956 was reviewed July 2, 1957 by the Internal Revenue Service. The only adjustments agreed to by your client were the disallowance of $96,544.00 charged to maintenance and repairs, which was capitalized as Building by the revenue agent and a charge to depreciation, based on the remaining life of the building estimated to be 40 years, allowed thereon. Management decided not to change its property records or the general ledger accounts for these changes. On August 17, 1957 the bill for additional assessment was received:

Tax	$48,947.81
Interest at 6%	2,692.13
Total	$51,639.94

During the year the Corporation paid $45,000 to the trustee of its pension plan, previously approved by Internal Revenue Department ruling. A statement from the trustee for the fiscal year ended June 30, 1958 discloses that the trustee disbursed a net of $42,858 to an insurance company in the form of premiums.

An audit of credits issued during July 1958 disclosed that certain items sold by the Corporation were defective. An intensive study indicated approximately $25,000 of sales would be returned. A charge to sales allowances and a credit to reserve for estimated losses was made to reflect the liability of the client to customers for these sales.

An examination of the insurance policies on the lives of the officers reveals the Corporation to be the beneficiary.

During the year ended June 30, 1954, the year of inception of the Corporation's pension plan, $546,000 was paid by your client for past services of its employees; 90% of the payment was disallowed in that year for tax purposes, the balance to be taken over the next succeeding 9 years.

Required:

a. Compute the correct federal income tax liability as of June 30, 1958.

b. Prepare journal entries, with appropriate explanations, to adjust the federal income tax liability account at June 30, 1958. (No liability in excess of that computed is to be provided.)

Number 3 (Estimated time—25 to 40 minutes)

X, Y and Z agree to sell hot dogs on July 3 and 4. X agrees to construct a stand on the front lawn of Z and charge the cost to operations. Z agrees to the use of his front lawn, but asks $25 for the cost of sod replacement and cleaning up his lawn after July 4. X, Y and Z decide that profits, if any, will be distributed first by the $25 payment to Z and then by a 40% commission on individual sales. The balance will be distributed 75% to X and 25% to Y. They agree that a cash box will only complicate matters and that all purchase and sales transactions will be out-of-pocket and the responsibility of the individual. Sales to X, Y and Z are to be at cost, except that the ending inventory may be purchased at 50% of cost. All other sales are to be made at 100% mark-up on cost.

The activity of the venture is as follows:

July 2

X constructs the stand on the front lawn of Z at a cost of $100.

July 3

X pays $1,000 for supplies. Z pays $50 for a permit to operate the concession.

July 4

X purchases additional supplies for $1,500, using $500 given to him by Y and $1,000 of his own money.

Sales for the day were as follows:

X	$1,700
Y	2,600
Z	600

July 5

Z pays $90 for fire extinguishers and these are distributed equally between X, Y and Z for their personal use at home.

Z agrees to pay $50 for the stand.

The balance of the inventory was taken by X.

Required:

Prepare a worksheet analysis of the transactions which will give X, Y and Z the following information:

a. Net profit or loss from the operation.

b. Distribution of profit or loss to X, Y and Z.

c. The final cash settlement.

Number 4 (Estimated time—45 to 65 minutes)

The federal income tax returns of X Company for the years 1955 and 1956 have been examined by the Internal Revenue Service. The Company has calculated depreciation on a four-year life. Salvage value was not used in the calculation and was not questioned by the Internal Revenue Service auditor. The only change has been the disallowance of the use of the sum-of-the-years-digit method for computing depreciation because two automobiles were not held for three years. In the tax audit, to which the client and the IRS supervisor agreed, a change was made to the straight-line method of computing depreciation.

The company owns or has owned the following automobiles:

Car	*Purchased*	*Sold*	*Cost*	*Sales price*
A	3/31/55	6/30/57	$2,400	$1,500
B	9/30/55	On hand	3,200	
C	4/30/56	12/31/57	3,600	2,000
D	7/31/57	On hand	4,800	

Depreciation has been computed to the nearest month.

The income including gains on sale of automobiles has been $5,000 in each of the years 1955, 1956 and 1957 after providing depreciation on the sum-of-the-years-digit method. Effective tax rates on such income were 30%, and 25% on capital gains, in each year.

Depreciation and federal income taxes have been provided for the year 1957 based on the company's method. The company wishes to keep its books on the same basis as that used for tax purposes.

Required:

Prepare adjusting entries on the clean surplus theory (all inclusive income statement), as of December 31, 1957 for each account affected by the change of depreciation method except that no accrual for interest should be made. The books have NOT been closed. (Support each item with organized computations.)

GROUP II

(Estimated time—50 to 80 minutes)

(Solve only one problem in this group. If both are answered, only the first will be considered.)

Number 5

The King Process Company manufactures one product, processing it through two processes—#1 and #2.

For each unit of Process #1 output, 2 units of raw material X are put in *at the* *start* of processing. For each unit of Process #2 output, 3 cans of raw material Y are put in *at the end* of processing. Two pounds of Process #1 output are placed in at the start of Process #2 for each unit of finished goods started.

Spoilage generally occurs in Process #2 when processing is approximately 50% complete.

In-process accounts are maintained for raw material, conversion costs, and prior department costs.

The company uses FIFO basis for inventory valuation for Process #1 and finished goods, and AVERAGE cost for inventory valuation for Process #2. Data for March:

(1) Units transferred:

From Process #1 to Process #2	2,200 lbs.
From Process #2 to Finished Goods	900 gallons
From Finished Goods to Cost of Goods Sold	600 gallons

(2) Units spoiled in Process #2—100 gallons

(3) Raw material unit costs: X—$1.51 per unit Y—$2.00 per can

(4) Conversion costs: Process #1—$3,344; Process #2—$4,010

(5) Spoilage recovery: $100 (treated as cost reduction)

(6) Inventory data:

	Process #1		*Process #2*		*Finished Goods*	
	Initial	*Final*	*Initial*	*Final*	*Initial*	*Final*
Units	200	300	200	300	700	1,000
Fraction Complete Conversion Costs	1/2	1/3	1/2	2/3		
Valuation:					$13,300	
Materials	$560		0			
Conversion Costs	$108		$390			
Prior Department Costs			$2,200			

Required:

Journalize March entries to record the transfer of costs from Process #1 to Process #2, from Process #2 to Finished Goods, and from Finished Goods to Cost of Goods Sold. Prepare schedules of computations to support entries.

Number 6

You have been requested to review the records of the City of Battle River, Michigan. The enclosed worksheet contained a trial balance taken from the books of the City is submitted to you in connection with your assignment.

You are requested to:

a. Classify the trial balance amounts by funds on the worksheet furnished. (See notes in regard to funds on p. 92.)

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION FORM H

Candidate's No.______
State and Date______
Subject______
Problem______ Page of Answers______

City of Battle River, Michigan
Funds
June 30, 1958

Number 6

ACCOUNT DEBITS	COMBINED	GENERAL	BRIDGE "A" BOND	SINKING	WORKING CAPITAL	SPECIAL ASSESSMENT	TRUST	UTILITY	FIXED ASSETS	GENERAL BONDED DEBT	AGENCY
ACCOUNTS RECEIVABLE — GENERAL FUND	$ 10 000										
AMOUNT AVAILABLE FOR RETIREMENT OF BONDS	151 000										
AMOUNT TO BE PROVIDED FOR RETIREMENT OF BONDS	149 000										
APPROPRIATION EXPENDITURES	375 900										
ASSESSMENTS RECEIVABLE — CURRENT	5 000										
ASSESSMENTS RECEIVABLE — DEFERRED	35 000										
ASSESSMENT SALE CERTIFICATES	5 000										
BONDS AUTHORIZED — UNISSUED	100 000										
CASH IN BANKS (SEE NOTE #1)	350 000										
CASH FOR CONSTRUCTION	10 000										
CASH FOR INTEREST PAYMENTS	5 000										
CONSTRUCTION EXPENDITURES	385 000										
CONSTRUCTION WORK IN PROGRESS — FIXED ASSETS FUND	50 000										
COST OF SERVICES RENDERED	40 000										
DUE FROM AGENCY FUND (FOR GENERAL FUND)	50 000										
DUE FROM GENERAL FUND (WORKING CAPITAL FUND)	5 000										
DUE FROM UTILITY FUND (WORKING CAPITAL FUND)	10 000										
ENCUMBRANCES (SEE NOTE #2)	70 000										
ESTIMATED REVENUES	400 000										
EXPENDITURES — BRIDGE	100 000										
EXPENDITURES CHARGEABLE AGAINST RESERVE FOR ENCUMBRANCES	5 100										
FIXED ASSETS (SEE NOTE #3)	1 735 000										
GOVERNMENTAL UNIT'S SHARE OF COST	10 000										
IMPROVEMENTS AUTHORIZED	15 000										
INTEREST AND PENALTIES RECEIVABLE ON TAXES (SEE NOTE #4)	9 000										
INVENTORY MATERIALS AND SUPPLIES (SEE NOTE #5)	25 000										
INVESTMENTS (SEE NOTE #6)	318 000										
OPERATING EXPENSE	75 000										
PREPAID INSURANCE	10 000										
REQUIRED ANNUAL EARNINGS	5 000										
REQUIRED INSTALLMENT CONTRIBUTIONS	45 000										
TAXES EXPENSE	5 000										
TAXES RECEIVABLE (SEE NOTE #7)	227 000										
TAXES RECEIVABLE FOR OTHER UNITS	70 000										
UTILITY'S CUSTOMERS' DEPOSIT CASH FUND	40 000										
UTILITY'S SINKING FUND ASSETS	100 000										
TOTAL DEBITS	$5 000 000										

UNIFORM CERTIFIED PUBLIC ACCOUNTANT EXAMINATION FORM H

CANDIDATE'S NO.________
STATE AND DATE________
SUBJECT________
PROBLEM______PAGE OF ANSWERS______

City of Battle River, Michigan
Funds
June 30, 1958

Number 6 — continued — Page 2

ACCOUNT CREDITS	COMBINED	GENERAL	BRIDGE "A" BOND	SINKING	WORKING CAPITAL	SPECIAL ASSESSMENT	TRUST	UTILITY	FIXED ASSETS	GENERAL BONDED DEBT	AGENCY
ACCRUED LIABILITIES — UTILITY FUND	$ 5 000										
APPROPRIATIONS	380 000										
BILLINGS FOR SERVICE	41 000										
BONDS PAYABLE (SEE NOTE #8)	550 000										
CAPITAL	50 000										
CONTRACTS PAYABLE	25 000										
CONTRACTS PAYABLE — RETAINAGE	5 000										
CONTRIBUTION REVENUE	45 000										
DUE TO GENERAL FUND (FROM AGENCY FUND)	50 000										
DUE TO WORKING CAPITAL FUND (SEE NOTE #9)	15 000										
EARNINGS — SINKING FUND	6 000										
ENDOWMENT EARNINGS FUND BALANCE	10 000										
ENDOWMENT PRINCIPAL FUND BALANCE	100 000										
GOVERNMENTAL UNIT'S CONTRIBUTION AND GRANTS IN AID	500 000										
MATURED BONDS PAYABLE	50 000										
OPERATING REVENUE	90 000										
RESERVE FOR AUTHORIZED EXPENDITURES (SEE NOTE #10)	600 000										
RESERVE FOR DEPRECIATION (SEE NOTE #3)	33 000										
RESERVE FOR ENCUMBRANCE (SEE NOTE #11)	75 000										
RESERVE FOR ESTIMATED LOSSES	38 500										
RESERVE FOR RETIREMENT OF UTILITY AND SINKING FUND BONDS	90 000										
REVENUES	404 000										
SURPLUS AND FUND BALANCES	1 492 500										
TAXES COLLECTED IN ADVANCE	10 000										
TAXES FUND BALANCE	80 000										
UNAPPROPRIATED SURPLUS — INTEREST — ASSESSMENT FUND	5 000										
UTILITY'S CUSTOMERS' DEPOSIT PAYABLE	40 000										
UTILITY SINKING FUND REVENUE	10 000										
VOUCHERS PAYABLE (SEE NOTE #13)	200 000										
TOTAL CREDITS	$5 000 000										

Notes:	#1	#2	#3		#4	#5	#6	#7	
			Fixed Assets		*Interest*	*Inv. Mat.*		*Taxes Receivable*	
Funds	*Cash in Bank*	*Encum- brances*	*Cost*	*Reserved*	*and Penalties*	*and Supplies*	*Invest- ments*	*Cur- rent*	*Delin- quent*
General	$ 10,000	$20,000			$4,000			$100,000	$70,000
Bridge "A" Bonds	80,000	20,000							
Sinking Fund	80,000				$ 5,000		$218,000	50,000	7,000
Working Capital	10,000					$ 5,000			
Land			$ 5,000						
Buildings .			20,000	$ 2,000					
Equipment.			10,000	1,000					
Special Assessment .		30,000							
Trust	10,000						100,000		
Utility	100,000					20,000			
Land			50,000						
Buildings .			400,000	20,000					
Equipment.			200,000	10,000					
Fixed Assets Land			55,000						
Buildings .			550,000						
Equipment.			250,000						
Structures .			195,000						
Agency	60,000								
	$350,000	$70,000	$1,735,000	$33,000	$9,000	$25,000	$318,000	$150,000	$77,000

Notes:	#8	#9	#10	#11	#12			#13
					Reserve for Estimated Losses			
Funds	*Bonds Payable*	*Due to Work. Cap.*	*Res. Author. Expenditure*	*Res. for Encum- brances*	*Current*	*Delin- quent*	*Int. & Pen.*	*Vouchers Payable*
General		$ 5,000		$25,000	$10,000	$20,000	$1,000	$140,000
Bridge "A" Bonds			$200,000	20,000				45,000
Sinking Fund ..	$300,000				5,000	2,000	500	
Working Capital								10,000
Special Assessment ...	50,000		400,000	30,000				
Utility	200,000	10,000						5,000
	$550,000	$15,000	$600,000	$75,000	$15,000	$22,000	$1,500	$200,000

b. Prepare in good form, balance sheets as of June 30, 1958, the end of the first six months of an annual fiscal period, for:
   (1) General fund
   (2) Utility fund
   (3) Special Assessment fund

EXAMINATION IN AUDITING

November 6, 1958; 9 a.m. to 12:30 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—25 to 35 minutes)

Standards of field work include the statement that *there is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.* Another standard of field work states that *sufficient competent evidential matter is to be obtained. . . .*

a. What are the major characteristics of a satisfactory system of internal control?

b. List six sources of evidence about a given system of internal control which are available to an auditor, and state briefly how the evidence from each source can be used in evaluating the system of internal control.

Number 2 (Estimated time—15 to 20 minutes)

Mr. Alexander, president of the Alpha Corporation, has engaged you to make an audit of the corporation's records. You are not familiar with the type of business of the corporation. Mr. Alexander advises you that he would like to have an approximation of the cost of the examination.

List the steps you would take to provide the requested estimate.

Number 3 (Estimated time—30 to 40 minutes)

A processor of frozen foods carries an inventory of finished products consisting of 50 different types of items valued at approximately $2,000,000. About $750,000 of this value represents stock produced by the company and billed to customers prior to the audit date. This stock is being held for the customers at a monthly rental charge until they request shipment and is not separated from the company's inventory.

The company maintains separate perpetual ledgers at the plant office for both stock owned and stock being held for customers. The cost department also maintains a perpetual record of stock owned. The above perpetual records reflect quantities only.

The company does not take a complete physical inventory at any time during the year since the temperature in the cold storage facilities is too low to allow one to spend more than 15 minutes inside at a time. It is not considered practical to move items outside or to de-freeze the cold storage facilities for the purpose of taking a physical inventory. Due to these circumstances, it is impractical to test count quantities to the extent of completely verifying specific items. The company considers as its inventory valuation at year end the aggregate of the quantities reflected by the perpetual record of stock owned, maintained at the plant office, priced at the lower of cost or market.

a. What are the two principal problems facing the auditor in the audit of the inventory? Discuss briefly.

b. Outline the audit steps that you would take to enable you to render an unqualified opinion with respect to the inventory. (You may omit consideration of a verification of unit prices and clerical accuracy.)

Number 4 (Estimated time—30 to 40 minutes)

What are the limitations in applying the generally accepted auditing standard of *an opinion as to conformity of financial statements with generally accepted principles of accounting?* Indicate the general effects of its application on the wording of the opinion in the auditor's *special report* on the statements of each of the two following cases.

(1) The financial statements of the XYZ Market, a retail grocery operated as an individual proprietorship, are prepared on the basis of cash receipts and disbursements. These statements do not purport to present the financial position and results of operation of the company.

(2) The financial statements of the Raintree County Hospital, a private non-profit organization, are prepared in accordance with the principles and practices of uniform accounting prescribed by a national hospital association. These statements purport to present the financial position and results of operation of the hospital.

GROUP II

(Estimated time—60 to 75 minutes)

(Answer any two questions in this group. If more are answered, only the first two will be considered.)

Number 5

You are engaged as the auditor for an employees' profit-sharing pension trust which has been in existence for a number of years. Each qualified employee has an equity in the trust which the employee is entitled to receive when he leaves the company. The membership of participating employees changes each year because additional employees qualify while others are retired. The amount of equity received varies with length of service from zero for the first five years up to 100% with ten years of service. The trust agreement does not state how the fund's assets should be valued.

The trust's assets consist of the following:

	Cost	*Market*
Cash	$ 50,000	$ 50,000
Rental properties (building)	100,000	250,000
Stocks	1,000,000	1,250,000
Bonds	500,000	400,000

a. You are requested to give the trustees your recommendations for the valuation of the trust's assets in certified financial statements and the reasons for your recommendations.

b. Would your opinion be a standard opinion or would you vary it, and, if so, how?

c. The trustees inform you that the trust has entered into a ten-year lease on the rental property. The trust is to receive annual rents of $21,000 for ten years and the lessee has the option to purchase the building for $125,000 at the end of the lease. The lessee has installed an expensive air conditioning system, and has expended substantial sums for remodeling and modernization. The trustees would like your recommendations for valuing the building in the accounts this year and in the future, and your suggestions for the proper accounting entries to record the yearly $21,000 payments.

d. What disclosure, if any, of the lease should be made in the financial statements?

Number 6

You are engaged in an audit of the records of a trucking concern for the year 1958. You find that the company finances the purchase of most of its trucks under lease bailment contracts with the First National Bank in Brendon. The contracts provide for rental payments in equal monthly installments over a period of 4 years at the end of which time the company obtains title to the trucks. However, the company reserves the right to terminate the rental agreements at any time during the period of the leases upon relinquishing possession of the trucks to the bank. The estimated useful life of all trucks used in the business is 5 years and the company provides for depreciation on all of its depreciable property on the straight-line basis.

The company has not been consistent in completing contract payments and in obtaining titles to trucks at the end of the period of the agreements. Since 1951 fifty contracts have been negotiated by the company, three of which are still in effect and ten on which payments had not been completed. Possession of the trucks under the latter contracts was relinquished to the bank. The company has followed a policy, with which you agree, of recording trucks in the accounts when payment was completed and title was obtained by the company. During the year 1958 the three bailment lease contracts in effect were as follows:

Contract Number	*Term of Contract From*	*To*	*Monthly Installments*	*Total Installments*
1	1/1/58	12/31/61	$2,500	$120,000
2	4/1/54	3/31/58	2,000	96,000
3	6/1/56	5/31/60	3,000	144,000
	Total		$7,500	$360,000

a. As a means of checking the entries made in the accounts during the year, you are to prepare a worksheet summarizing the following transactions, assuming that all monthly payments have been made under the contracts and that salvage value is to be disregarded.
   (1) Recording the contract entered into at January 1, 1958.
   (2) Total installments paid under all contracts during the year 1958.

(3) Provision for depreciation, if any, on trucks covered by the above contracts during the year.

b. Present the disclosures, if any, relating to the lease bailment contracts which you would make on the balance sheet at December 31, 1958.

Number 7

You have been retained by a municipal water district to conduct an audit of the books and records for the year ended June 30, 1958. The Board of Commissioners advise you that they wish a *certified audit* for the year and that the last time the books of the District had been audited by a certified public accountant was as of June 30, 1954.

During the audit, you discover that the bank account appears to be short in the amount of $3,750. You also note that the shortage appears to represent the difference between the acknowledged receipts and the deposits to the bank for the months of July to February, inclusive. You also note that all funds have been properly recorded and deposited subsequent to February, at which time a new manager was hired for the District. You also learn that at the same time an old and trusted veteran office worker retired from service. During your discussion of general procedures and bookkeeping routine with the manager, another office clerk with six years' service to the District submitted notice of resignation to become effective in two weeks. The manager also advises you that during the month of April 1958, there had been a shortage of $40 in one day's receipts and that he had been unable to determine the cause of this shortage.

a. Outline the audit steps you would take in connection with this cash shortage.

b. Could you render an unqualified opinion in your report on this engagement? Explain briefly.

c. Describe briefly the comments you would include in your report regarding the cash shortage.

EXAMINATION IN COMMERCIAL LAW

November 7, 1958; 9 a.m. to 12:30 p.m.

GROUP I

(Answer all six questions in this group)

Number 1 (Estimated time—15 to 20 minutes)

Clark draws a check to his order on the Tenth National Bank to which he forges the signature of Brown and negotiates it by unqualified indorsement to the order of Evans, a holder in due course. Evans negotiates it by unqualified indorsement to the order of Reade, also a holder in due course. Reade indorses it without qualification, and presents it for payment to the Tenth National Bank. The bank accepts the check and pays its amount to Reade.

a. Is Brown liable on the check to any party? Explain.

b. What, if any, and to whom, is the civil liability of Clark on the check? Explain.

Number 2 (Estimated time—20 to 30 minutes)

a. Kemp promises in writing to deliver to Bradner at a fixed and stated price all of Kemp's product that Bradner may desire during the next eight months. In exchange for Kemp's promise, Bradner promises in writing that he will buy all he desires of Kemp's product during the stipulated period and at the stipulated price.

   Has a contract been made? Explain.

b. Greene, after visiting Thurber's farm and inspecting two particular parcels of land sown to wheat, entered into a written agreement with Thurber to purchase at a fixed and stated price the entire wheat crop to be harvested from the two particular and specified parcels of land. The agreement was expressly one to purchase the specific wheat crops indicated, and not simply an agreement to buy a given quantity of wheat from Thurber. Subsequently the crops on the two specified parcels were destroyed by blight before harvest time. Thurber notified Greene of such destruction prior to the agreed delivery date. Shortly after the date for delivery, Greene brought suit against Thurber for breach of contract, claiming failure to perform under the agreed terms. Thurber pleaded in defense that his contractual obligation had been discharged by reason of impossibility of performance due to destruction of the specified wheat.

   Which contention will prevail? Explain.

c. Assume the same agreement as in (b), with the following changes in developments. The crops were not destroyed by blight, but before harvest time Thurber sold the two specified parcels of land to Allen, together with the crops growing thereon. Legal title was duly conveyed to Allen. Prior to the agreed date for delivery of the wheat to Greene, Thurber notified Greene of the sale of the land and the crops thereon and that the sale would make it impossible to perform his agreement. Shortly after the agreed delivery date, Greene brought suit against Thurber for breach of contract, claiming failure to perform under the agreed terms. Thurber pleaded in defense that his contractual obligation had been discharged by reason of impossibility of performance due to the transfer of the land and crops to Allen.

Which contention will prevail? Explain.

Number 3 (Estimated time—10 to 15 minutes)

Mercer, offering goods for sale to Forsythe, accompanied the offer with an express warranty intended to induce Forsythe to purchase the goods. Forsythe, relying upon the warranty, contracted to buy the goods. After execution of the contract but before delivery, Forsythe discovered that the goods so far failed to correspond with Mercer's representations as to constitute an actual breach of warranty.

What remedies are available to Forsythe?

Number 4 (Estimated time—25 to 35 minutes)

The X Corporation proceeded at its annual election of stockholders to the election of seven new members of its Board of Directors. One thousand shares were qualified to vote under an authorized system of cumulative voting. The voting stockholders were divided into two groups, one a majority faction of two stockholders, Young and Stephens, with 425 shares each for a combined total of 850 shares, and the other a minority faction consisting of one stockholder, Gordon, holding 150 shares. In the voting for duly nominated and qualified candidates, both factions sought to elect as many directors as possible favorable to their particular factional interest. The duly certified result of the election showed that six directors favored by the majority stockholders and one favored by the minority stockholder had been chosen.

a. (1) Explain the basic purpose of cumulative voting and how it operates.
   (2) Could the majority stockholders have used their 850 shares under such system in such a way as to elect seven directors favorable to their views? Explain.

b. Explain fully the meaning of the words *cumulative* and *participating* when applied to preferred stock.

c. Define the following types of corporate bonds.
   (1) Debenture
   (2) Income
   (3) Collateral trust
   (4) Participating
   (5) Convertible

Number 5 (Estimated time—15 to 20 minutes)

a. Osmun, a creditor, holds collateral belonging to Raines, his debtor, to secure payment of the debt. In addition, Conklin has guaranteed to Osmun payment of Raines' debt. The debt falls due and Raines defaults. Conklin pays Osmun in full. Who is now entitled to the collateral? Why?

b. Levins sold to Masters real property on which Endicott held a first mortgage contracted by Levins. Under the terms of the written agreement for the purchase Masters expressly assumed the mortgage debt. Subsequent to the purchase by Masters there was default in payment on the mortgage as to the entire principal sum. Endicott thereupon sought to enforce payment of the mortgage debt against Masters personally. Masters contended that Endicott should have proceeded against Levins, the original mortgagor, as being liable as principal with respect to mortgage debt.

Explain fully the respective liabilities, if any, of Masters and Levins to Endicott and as to each other.

Number 6 (Estimated time—20 to 30 minutes)

On March 31, 1958 your client, John Miller, entered into an agreement with a syndicate to purchase all of the capital stock of Textiles, Inc. The price agreed upon was $300,000 less the amount of the liabilities of the corporation as of March 31, 1958. The agreement provided also that the amount of liabilities was to be determined by a CPA acting for Miller. You are engaged by Miller for this special purpose. The only item presenting a problem for you is a written claim by one Darrow for 10% of the profits for the first quarter of 1958. While there is no entry in the books of account showing any liability or payments to Darrow, you find that the minutes of the Board of Directors record that in December 1957 the employment of Darrow as a salesman was authorized effective January 1, 1958 for the period of one year, his sole compensation to be "a substantial percentage of the profits," and an accounting and settlement to be made quarterly. You establish that Darrow rendered substantial services as a salesman during the first quarter of 1958 pursuant to an agreement giving effect to the Board's authorization, that there had been an actual profit of $20,000 for the first quarter of 1958, that this sum was the amount on which Darrow's percentage was to be figured, and that Textiles, Inc., and Darrow had been awaiting the outcome of operations for the first quarter to agree definitely on the specific percentage of the profits he should receive.

1. Do the facts indicate that Darrow has a good cause of action against the corporation? Explain.

2. To what extent would the Darrow claim affect or limit your accounting report to Miller as to the amount of liabilities as of March 31, 1958? Explain.

3. In reporting to your client the facts regarding the Darrow claim, what professional opinion, recommendation or advice would you give him as to what should be done to ascertain the amount of liability to Darrow, if any? Explain.

4. Would you include in your professional opinion, recommendation, advice or comment on any statement as to whether (a) Darrow's claim is valid, or (b) he has a cause of action, or

(c) he might recover any particular amount or percentage were his claim valid? Explain.

GROUP II

(Estimated time—40 to 60 minutes)

(Answer only two questions in this group. If more are answered, only the first two will be considered.)

Number 7

a. Tom Thumb, a boy thirteen years of age who has lost his parents and has no guardian, is employed in a cotton mill engaged in interstate commerce.
   (1) What Federal statute affects or applies to his employment?
   (2) Does the statute authorize or prohibit his employment? Explain.

b. The K Chemical Company, engaged in interstate commerce, hired a group of two hundred workmen to render certain specified services at a weekly salary of $40 each for a forty-hour Monday to Friday, inclusive, five-day week. It was expressly agreed that for any hours in excess of eight that they worked on any day of the five-day week and for any hours at all that were worked on a Saturday the men would be paid at a premium rate of $1.50 an hour. During the first week the men worked the forty hours for the normal five-day week plus four additional hours on Thursday and eight hours on Saturday. Each received total pay of $58 (before tax and other deductions). This was figured at $40 for the forty-hour week, and at $18 for the twelve additional hours at the agreed premium rate of $1.50 an hour. The men claimed they should have received $60.07 each because (1) the National Fair Labor Standards Act (Wages and Hours Law) provides that employees working hours in excess of a forty-hour workweek are to be compensated for such excess at a rate not less than one and a half times the regular rate at which they are employed, (2) the Act provides the regular rate will be deemed to include all remuneration for employment paid to employees, and (3) the regular rate should have been computed therefor on the basis of 52 hours worked for a total regular pay of $58, which would make the regular rate for the week $1.11½ an hour and entitle the men to $60.07 each computed at $40 for forty hours plus $20.07 for twelve hours at $1.67¼ per hour.
   (1) Should the four hours of overtime on Thursday have been included, as the men contended, in computing the regular rate of compensation? Explain.
   (2) Should the eight hours of work on Saturday have been included, as the men contended, in computing the regular rate of compensation? Explain.

Number 8

The Astoria Fire Insurance Company issues a fire insurance policy to a partnership in the firm name of Davis, Johns and Rhinebeck on a building owned by the partnership. Davis, Johns and Rhinebeck are the only partners and the policy contains no provision making the policy still effective in the event of change in partners.

a. Johns withdraws by selling his entire interest to the other two partners and the firm continues business as Davis and Rhinebeck.

Does Johns' withdrawal make the policy void as to Davis and Rhinebeck? Explain.

b. Instead of withdrawal, there is an addition to the firm. It becomes Davis, Johns, Rhinebeck and Travis.

Does the admission of Travis as an additional partner make the policy void as to Davis, Johns, Rhinebeck and Travis? Explain.

Number 9

Bevins executed and delivered to Smathers a negotiable promissory note for \$2,000 payable in six months. Before maturity Smathers indorsed and delivered the note to Engstrom as collateral security for payment of a loan of \$1,000 made by Engstrom to Smathers. Thereafter, and before maturity, consideration by Smathers for the note given him by Bevins failed completely so that Bevins would have had a full defense to action by Smathers on the note. Smathers, having paid \$200 on account to Engstrom on his loan, defaulted on the balance of \$800 when due. After such default by Smathers, Bevins' note having matured, Engstrom sued Bevins for the face value of the note (\$2,000). Bevins contended that as he had a full defense against Smathers for complete failure of consideration such defense would also bar recovery by Engstrom. Engstrom contended in turn that he was a holder in due course and that the defense available to Bevins against Smathers was therefore of no effect against him. Bevins made a final argument that even if Engstrom were a holder in due course he could not recover more than \$800 on the note, that being the amount for which Smathers was in default.

On the foregoing facts and contentions,

1. Could Engstrom recover on the note against Bevins, and, if so, in what amount? Explain.
2. Is a defense of failure of consideration a personal defense or a real defense? Explain.
3. Is a personal defense effective against a holder in due course? Explain.
4. Is Bevins' contention that Engstrom can only recover \$800 valid? Explain.

EXAMINATION IN THEORY OF ACCOUNTS

November 7, 1958; 1:30 to 5:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—25 to 35 minutes)

The transactions listed below relate to Jekyll Chemicals, Inc. You are to assume that *on the date* on which each of the transactions occurred the corporation's accounts showed only common stock ($100 par) outstanding, a current ratio of 2½:1 and a substantial net income for the year to date (before giving effect to the transaction concerned). *On that date* the *book value* per share of stock was $146.48.

Each numbered transaction is to be considered completely independent of the others, and its related answer should be based on the effect(s) of that transaction alone. Assume that all numbered transactions occurred during 1957 and that the amount involved in each case is sufficiently material to distort reported net income if *improperly* included in the determination of net income. Assume further that each transaction was recorded in accordance with generally accepted accounting principles and, where applicable, in conformity with the *current operating concept* of the income statement.

For each of the numbered transactions you are to decide whether it:

A. Increased the corporation's 1957 net income.

B. Decreased the corporation's 1957 net income.

C. Increased the corporation's total retained earnings *directly* (i.e., *not* via net income).

D. Decreased the corporation's total retained earnings *directly.*

E. Increased the corporation's current ratio.

F. Decreased the corporation's current ratio.

G. Increased each stockholder's *owner's equity.*

H. Decreased each stockholder's *owner's equity.*

I. Increased each stockholder's equity per share of stock.

J. Decreased each stockholder's equity per share of stock.

K. Had none of the above effects.

Required:

List the numbers 1 through 10 on your answer sheet. Select as many letters as you deem appropriate to reflect the effect(s) of each transaction as of the date of the transaction by *printing* beside the transaction number, the *capital* letter(s) which identifies that transaction's effect(s).

TRANSACTIONS

1. Treasury stock, which had been repurchased at and carried at $102 per share, was issued as a stock dividend. In connection with this distribution the board of directors of Jekyll Chemicals, Inc., had authorized a transfer from retained earnings to permanent capital of an amount equal to the aggregate market value ($104 per share) of the shares issued. No entries relating to this dividend had been made previously.

2. In January the board directed the write-off of certain patent rights which had suddenly and unexpectedly become worthless.

3. The corporation wrote off a *portion* of the unamortized discount and issue expense applicable to bonds which it refinanced in 1957. It intends to amortize the remainder over the next 7 years, the remaining life of the new issue, although the bonds would have had 12 more years to run had they not been refunded.

4. Treasury stock originally repurchased and carried at $101 per share was sold for cash at $103.50 per share.

5. The corporation sold at a profit land and a building which had been idle for some time. Under the terms of the sale, the corporation received a portion of the sales price in cash immediately, the balance maturing at six-month intervals.

6. The board of directors authorized the write-up of certain fixed assets to values established in a competent appraisal.

7. The corporation called in all its outstanding shares of stock and exchanged them for new shares on a 2-for-1 basis, reducing the par value at the same time to $50 per share.

8. The corporation paid a cash dividend, the declaration for which had been recorded in the accounts at time of declaration.

9. Litigation involving Jekyll Chemicals, Inc., as defendant was settled in the corporation's favor, with the plaintiff paying all court costs and legal fees. The corporation had appropriated retained earnings in 1956 as a special contingency reserve for this court action, and the board directs abolition of the reserve.

10. The corporation received a check for the proceeds of an insurance policy from the company with which it is insured against theft of trucks. No entries concerning the theft had been made previously, and the proceeds reduce but do not cover completely the loss.

Number 2 (Estimated time—20 to 30 minutes)

The generally accepted rule in accounting is that revenue is recognized when the sale is made.

a. Why has the sale been chosen as the point at which to recognize the revenue resulting from the entire producing and selling process?

b. What is the justification for the following deviations from recognizing revenue at the time of sale?
   (1) Installment sales method of recognizing revenue.
   (2) Recognition of revenue during production in gold mining.
   (3) The percentage-of-completion basis in long-term construction contracts.

Number 3 (Estimated time—15 to 20 minutes)

a. What does the term *consistency* mean as it is used in accounting?

b. What does the term *conservatism* mean as it is used in accounting?

c. Give one illustration of the application of a rule of conservatism which results in an *apparent inconsistency*. Explain.

Number 4 (Estimated time—20 to 25 minutes)

Historical cost is the conventional base used in recording fixed assets.

a. State the principal types of items which should be included in the historical cost of a machine purchased. Discuss.

b. Would merchandise bought for resale be valued initially on the same basis? Explain fully including a discussion of each of the items mentioned in part a.

Number 5 (Estimated time—15 to 20 minutes)

The D. Hayes Cramer Company manufactures product C whose cost per unit is $1 of material, $2 of labor, and $3 of overhead costs. During the month of May, there were 1,000 units of product C spoiled. These units could be sold for $.60 each.

The accountant said that the entry to be made for these 1,000 lost or spoiled units could be one of the following four:

Entry No. 1	Spoiled goods	$ 600	
	Work in process—Materials		$ 100
	Work in process—Labor		200
	Work in process—Overhead		300
Entry No. 2	Spoiled goods	$ 600	
	Manufacturing expenses	5,400	
	Work in process—Materials		$1,000
	Work in process—Labor		2,000
	Work in process—Overhead		3,000
Entry No. 3	Spoiled goods	$ 600	
	Loss on spoiled goods	5,400	
	Work in process—Materials		$1,000
	Work in process—Labor		2,000
	Work in process—Overhead		3,000
Entry No. 4	Spoiled goods	$ 600	
	Receivable	5,400	
	Work in process—Materials		$1,000
	Work in process—Labor		2,000
	Work in process—Overhead		3,000

Indicate the circumstance under which each of the four above solutions would be appropriate.

GROUP II

(Estimated time—60 to 80 minutes)

(Answer any two questions in this group. If more are answered, only the first two will be considered.)

Number 6

The individual and consolidated statements of companies X and Y for the year ending December 31, 1957 are as follows:

	X Company	*Y Company*	*Consolidated*
Cash and receivables	$ 35,000	$108,000	$ 97,400
Inventories	40,000	90,000	122,000
Plant (net)	460,000	140,000	600,000
Appraisal increase in plant (net)			50,000
Investment in Y	245,000		—0—
X bonds owned		103,000	—0—
	$780,000	$441,000	$869,400
Current payables	$ 70,000	$ 23,000	$ 53,000
Dividends payable	10,000	8,000	12,400
Mortgage Bonds	200,000	50,000	150,000
Capital stock	300,000	200,000	300,000
Retained earnings	200,000	160,000	231,000
Minority interest			123,000
	$780,000	$441,000	$869,400
Sales	$600,000	$400,000	$760,000
Cost of sales	360,000	280,000	403,000
Gross profit	240,000	120,000	357,000
Operating expense	130,000	54,000	184,000
Operating profit	110,000	66,000	173,000
Interest income	1,800	5,000	1,800
Dividend income	11,200	—0—	—0—
Total	$123,000	$ 71,000	$174,800
Interest expense	$ 10,000	$ 3,000	$ 8,000
Provision for income taxes	56,000	34,000	90,000
Non-recurring loss			3,000
Minority share			5,400
Net income	$ 57,000	$ 34,000	$ 68,400
Dividends	20,000	16,000	24,800
Transfer to retained earnings	$ 37,000	$ 18,000	$ 43,600

X Company purchased its 70% interest in Y Company several years ago. X Company sells its product in part to Company Y for further processing, and in part to other firms. The inventories of Y Company included an inter-company mark-up at both the beginning and end of the year. Cash transfers are made between the companies according to working capital needs.

Early in 1957, Y Company purchased $100,000 face value of the bonds of X Company as a temporary investment. These are carried on Y's books at cost.

Required:

On the basis of the information you can develop from an analysis of the individual and consolidated statements, answer any four of the six questions below. Show clearly all computations necessary to support your answers.

1. Does X Company carry its *Investment in Y* on the cost or equity (accrual) basis? State the reason for your conclusion.
2. The *Appraisal increase* represents a revaluation of the total of Y Company's assets on the basis of the price paid by X Company for its interest in Y. What was the balance of Y's *Retained earnings* at date of acquisition?
3. Prepare a reconciliation schedule which will explain clearly the difference between X Company's *Retained earnings* at December 31, 1957, $200,000, and the *Consolidated retained earnings* at December 31, 1957, $231,000.
4. What is the nature of the *Non-recurring loss* on the consolidated income statement? Show the consolidating elimination entry from which it originated.
5. Show the amounts of inter-company debts, excluding the bonds, and show which company is the debtor and which is the creditor in each instance.
6. Prepare a schedule reconciling the sum of the *Cost of sales* of X and Y individually with the *Consolidated cost of sales*. Show clearly the inter-company mark-up in the beginning and ending inventories of Y Company and how you determined the amounts.

Number 7

The term *pension plan* has been referred to as *a formal arrangement for employee retirement benefits, whether established unilaterally or through negotiation, by which commitments, specific or implied, have been made which can be used as the basis for estimating costs.*

a. Where the cost of such a pension plan is material, what disclosure should be given in the financial statements of the company for the year in which the plan is adopted?
b. What is the preferable procedure for computing and accruing the costs under a pension plan? Explain.
c. In its analysis of retained earnings for the year ended October 31, 1958, the Hodot Company discloses a debit of $1,500,000 as a cost of past service benefits under its pension plan. Discuss.

Number 8

The Capital Budget Committee of the Walton Corporation was established to appraise and screen departmental requests for plant expansions and improvements at a time when these requests totaled $10 million. The Committee thereupon sought your professional advice and help in establishing minimum performance standards which it should demand of these projects in the way of anticipated rates of return before interest and taxes.

The Walton Corporation is a closely held family corporation in which the stockholders exert an active and unified influence on the management. At this date, the company has no long-term debt and has 1,000,000 shares of common capital stock outstanding. It is currently earning $5 million (Net income before interest and taxes) per year. The applicable tax rate is 50%.

Should the projects under consideration be approved, management is confident the $10 million of required funds can be obtained either:

(1) *By Borrowing*—via the medium of an issue of $10 million, 4 per cent, 20-year bonds.

(2) *By Equity Financing*—via the medium of an issue of 500,000 shares of common stock to the general public. It is expected and anticipated that the ownership of these 500,000 shares would be widely dispersed and scattered.

The company has been earning 12½ per cent return after taxes. The management and the dominant stockholders consider this rate of earnings to be a fair capitalization rate (8 times earnings) as long as the company remains free of long-term debt. An increase to 15 per cent or six and two-thirds times earnings would constitute an adequate adjustment to compensate for the risk of carrying $10 million of long-term debt. They believe that this reflects, and is consistent with, current market appraisals.

Required:

a. Prepare columnar schedules comparing minimum returns, considering interest, taxes, and earnings ratio, which should be produced by each alternative to maintain the present capitalized value per share.

b. What minimum rate of return on new investment is necessary for each alternative to maintain the present capitalized value per share?

Examination, May, 1959

EXAMINATION IN ACCOUNTING PRACTICE—PART I

May 13, 1959; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—20 to 30 minutes)

The following statements relate to federal income taxes under the 1954 Internal Revenue Code.

On a sheet of lined paper enter numbers from 1 through 25 each on a separate line. Select the letter which identifies the answer and enter on the appropriate line.

1. Mrs. A's husband died in 1957 and she is his sole survivor, there being no children. In determining her income tax for the year 1957 and 1958, she may avail herself of the benefits of income-splitting as a "surviving spouse." (A) True (B) False

2. B's son is a college student who has summer vacation earnings of $800 which he uses toward his own support. B furnishes the remainder of his support at a cost of $1,000. Since the son has to file a return and claims his own personal exemption of $600, B is not entitled to claim an exemption for him as a dependent. (A) True (B) False

3. C is a married man with three children and earns a salary of $3,600 per year. C also has certain stock investments from which he normally receives dividends of $150 per year. He is required to file a Declaration of Estimated Tax. (A) True (B) False

4. In June 1958 D purchased for $15,000 cash an annuity paying him $100 per month beginning July 15 and continuing for life. One-half of 3% of $15,000 or $225 is includible in his 1958 income and the remaining $375 represents a return of cost. (A) True (B) False

5. E receives a salary of $125 per week from an employer who has a plan under which he continues the payment of salaries to employees during periods of absence due to illness. E is absent due to illness for a period of two weeks during which period he is hospitalized for two days of the second week. E is entitled to exclude from gross income $100 per week for the entire period of absence. (A) True (B) False

6. F sells his personal residence which has a tax basis of $10,000 for $16,000. No selling expenses were incurred. Within one year from the date of sale he purchases a new residence at a cost of $14,000. Gain is recognized to the extent of $2,000 and the tax basis of the new residence is $10,000. (A) True (B) False

7. G owns a working interest in an oil lease on which his entire leasehold cost has been recovered through depletion claimed and allowed. Since his basis has been recovered in full, he is not entitled to any further deduction for depletion. (A) True (B) False

8. H exchanges a machine used by him in his business and having an adjusted tax basis of $2,000 for a similar machine having a fair market value of $2,200 and in addition receives $300 in cash. He has a taxable gain of $500. (A) True (B) False

9. In 1951 "I" sold stock which had cost him $5,000 to his son for $3,000. Upon sale of this stock by his son in 1958 for $6,000, the recognized gain is $3,000. (A) True (B) False

10. J owns stock of the X Company which declares a dividend payable December 31, 1957. The check was written and dated December 31, 1957, and mailed January 1, 1958. J, a cash basis taxpayer, receives the check in the regular course of mail delivery on January 2, 1958. The amount is includible in his 1957 income. (A) True (B) False

11. On December 15, 1957 K sells for $10,000, stock which cost him $11,000 and on January 5, 1958 he purchases identical stock for $10,000. The loss on the 1957 sale is not recognized and the basis of the stock purchased in January upon subsequent sale is $11,000. (A) True (B) False

12. L is president of Y Corporation and owns 30% of its outstanding stock. His wife is the owner of 25% of the stock. At December 31, 1957 the Corporation on the accrual basis has a liability to L for unpaid salary which it is unable to pay and which L, on the cash basis, did not take into 1957 income. The accrued salary is paid to L in September 1958. The amount will be taxable to him in 1958 but will not be allowable to the Corporation as a deduction in either 1957 or 1958. (A) True (B) False

13. M sells a piece of real estate for $50,000 with annual payments of $10,000 beginning in the year following the date of sale. His adjusted basis is $35,000. He may elect to report the profit in installments and, assuming the payments are received when due, report $3,000 of the profit as long-term capital gain in each of the five years. (A) True (B) False

14. In 1958 N sells for $5,000 stock which he received in 1954 as a gift at which time the stock had a fair market value of $4,500. The donor's adjusted tax basis for this stock was $5,500. N has a recognized loss of $500. (A) True (B) False

15. In the year 1958 O has the following gains and losses:

Loss on sale of machinery used in his business and held for more than 6 months	$ 5,000
Loss on condemnation of land used in the business and held for more than 6 months	10,000
Total	15,000
Less gain on sale of land (together with unharvested crop) used in the business and held for more than 6 months (land and crop sold in one transaction)	12,500
Net loss	$ 2,500

The net loss of $2,500 is fully deductible. (A) True (B) False

16. A certain corporation has properties the fair market value of which is considerably in excess of their adjusted tax basis. In July 1957 the corporation adopts a plan for complete liquidation, sells its properties in January 1958 and makes a distribution to its stockholders in June 1958 of all of its assets except certain assets retained to meet claims. The corporation pays a tax on the capital

gain resulting from the sale of its property. (A) True (B) False

17. P receives non-taxable stock rights in connection with certain stock owned by him. On the date of issuance of the rights, the stock is quoted ex-rights at \$22.25 per share and the rights are quoted at \$2.75. He is required to allocate a portion of the basis of his stock to the rights. (A) True (B) False

18. A corporation with a deficit of \$100,000 at December 31, 1957 has earnings of \$40,000 in the calendar year 1958. On December 31, 1958 it makes a distribution of \$20,000. The distribution is a taxable dividend to the stockholders. (A) True (B) False

19. In 1958 Q collects an account which he charged off and deducted as a business bad debt in 1951. Assuming that the deduction did not result in a reduction of tax in the year charged off or in any year to which a loss for that year might be carried, the recovery in 1958 may be excluded from income. (A) True (B) False

20. A corporation declares a dividend on its common stock payable either in cash or common stock at the election of the stockholders. If the stockholder elects to take stock, the dividend is non-taxable. (A) True (B) False

21. Taxpayer is 50 years old, single, and has good vision. He maintains a home for himself and his boyhood music teacher—a man now 76 years old, in poor health, who is not related to the taxpayer. Taxpayer has contributed more than half toward the support of this friend, whose only income was rental (gross) \$400 for the year.

On his tax return long-form 1040 taxpayer is entitled to deduct for personal exemptions an amount of: (A) \$600; (B) \$1,000; (C) \$1,200; (D) \$1,800; (E) Some other amount.

22. Taxpayer bought 100 shares of Acme Preferred stock for \$10,000 on January 1, 1951. On July 1, 1958 he received a taxable stock dividend of 10 shares of Acme common stock—par \$50 per share; market value \$60 per share. On October 1, 1958 he sold the ten Acme common shares for \$75 per share. He should report a taxable gain on the sale in amount of: (A) \$150; (B) \$250; (C) \$600; (D) \$750; (E) Some other amount.

23. The above gain should be reported as: (A) Long-term capital gain; (B) Short-term capital gain; (C) Ordinary income.

24. Taxpayer bought 100 shares of Columbia Preferred stock for \$10,000 on January 1, 1951. On July 1, 1958 he received a non-taxable stock dividend of 10 Preferred shares on the 100 shares purchased January 1, 1951. The stock was quoted on July 1, 1958 at \$124 per share. On October 1, 1958 he sold the ten Columbia Preferred shares at \$130 per share.

He should report a gain on the sale of the ten Preferred shares in the amount of: (A) \$330.91; (B) \$390.91; (C) \$1,240; (D) \$1,300; (E) Some other amount.

25. The above gain should be reported as: (A) Ordinary income; (B) Short-term capital gain; (C) Long-term capital gain.

Number 2 (Estimated time—25 to 40 minutes)

The law firm of Shroyer, Curry and Jones has decided to dissolve partnership as of June 30, 1958 and has called you in to render an accounting. The only records maintained are the check book and a daily record of cash received. The firm has been in existence for four years with equal capital investments, and profits are divided equally. The prior year's tax return indicates that the following expenditures had been capitalized for tax purposes prior to January 1, 1958:

	Asset	*Allowance January 1, 1958*
Office Furniture and Fixtures	$1,500	$ 450
Books	900	180
Automobile—Shroyer	2,000	600
Automobile—Curry	1,000	200
Automobile—Jones	3,000	600
	$8,400	$2,030

Cash receipts to June 30, 1958 amount to $60,000. A summary of cash disbursements follows:

Rent	$ 1,400
Wages and Salaries	2,102
Entertainment	4,000
Automobile and Miscellaneous	1,000
Withdrawals—Shroyer	9,000
Withdrawals—Curry	10,000
Withdrawals—Jones	12,000
	$39,502

The capital accounts of the partners as of January 1, 1958 were equal. Depreciation has been charged against partnership profits. Automobiles are depreciated over a five-year period and office furniture and fixtures and books over a ten-year period. The bank balance at June 30, 1958 is $29,998. The three partners have agreed to distribute the office furniture and fixtures in kind and they feel that the distribution will be equal. The automobiles, which were purchased from partnership funds, will be retained by the partners to whom they have been assigned. The books will be distributed to Shroyer.

Required:

A schedule of changes in partners' capital accounts from January 1, 1958 to June 30, 1958 and the final cash distribution to each partner.

GROUP II

(Estimated time—130 to 200 minutes)

(Solve only two problems in this group. If three are solved only the first two will be considered.)

Number 3

Required:

From the data below prepare:

a. A worksheet for a consolidated balance sheet as of December 31, 1958.
b. A consolidated balance sheet as of December 31, 1958.

1. Post-closing trial balances as of December 31, 1958:

	Company P	Company S-1	Company S-2
Investment in Company S-1			
(Acquired January 1, 1957)			
Common Stock (90%)	$200,000		
Preferred Stock (40%)	40,000		
Investment in Company S-2			
(70% Acquired January 1, 1958)	59,300		
Current Assets	50,000	$ 50,000	$40,000
Machinery & Equipment	40,000	20,000	30,000
Allowance for Depreciation—			
Machinery & Equipment	(20,000)	(15,000)	(10,000)
Bonds of Company S-2 (Par $10,000)	10,100		
All Other Assets	600	313,000	70,180
Current Liabilities	(20,000)	(20,000)	(20,000)
Bonds Payable—10 yrs., 4%, due December 31, 1963			(30,000)
Premium on Bonds Payable			(180)
Capital Stock—Common, Par $100	(300,000)	(250,000)	(60,000)
Capital Stock—Preferred, 5%, Par $100, Cumulative & Non-Participating		(100,000)	
Premium on Preferred Stock		(10,000)	
Retained Earnings	(60,000)	12,000	(20,000)
	—0—	—0—	—0—

2. The investment accounts are carried at cost.

3. At acquisition, dividends on Preferred Stock for 1955 and 1956 were in arrears. Preferred Stock has a liquidation value of par plus all dividends in arrears and is non-voting.

4. On January 1, 1958, Company S-1 declared a common stock dividend of $50,000 from Premium on Preferred Stock.

5. The Retained Earnings accounts showed the following:

	S-1	S12
January 1, 1957 Balance	$(10,000)	$14,000
Profits 1957	7,000	7,000
Cash dividends 1958—on January 1, 1958	(5,000)	
—on December 31, 1958		(6,000)
Profit & Loss 1958	(4,000)	5,000
Balance December 31, 1958	(12,000)	20,000

6. Inventory of Company P includes $5,000 merchandise purchased from S-2; cost to S-2 is marked up 25%.

7. Inventory of Company S-2 includes $2,000 merchandise purchased from S-1; mark-up by S-1 is 10% on selling price.

8. Current Liabilities include the following: Company S-1 owes Company P $1,000; Company S-2 owes Company P $2,000; Company S-1 owes Company S-2 $3,000; and Company P owes Company S-1 $2,000.

9. Machinery having a life of 10 years was purchased by Company P from Company S-1 on January 1, 1957 for $10,000. Cost to S-1 was $7,000.

10. Company S-2 neglected to amortize Premium on Bonds Payable for 1958.

Number 4

The MCB Corporation produces one principal product designated "Main-Line." Incidental to this production two additional products result—"Co-Line" and "By-Line." Material is started in process #1; the three products come out of this process. "Main-Line" is processed further through process #2; "Co-Line" is processed further through process #3; while "By-Line" is sold without further processing. The following data for February are available:

1. Material put in process #1, $12,000.
2. Conversion costs: Process #1, $8,000; Process #2, $4,000; Process #3, $300.
3. There were no beginning or ending in-process inventories.
4. Production and Sales data:

	Quantity Produced	*Quantity Sold*	*February Average Sales Price*	*Market Price End of February*
Main-Line	5,000	4,000	$6.00	$6.00
Co-Line	3,000	2,000	1.00	.90
By-Line	1,000	900	.50	.55

5. Selling and Administrative Expenses are related to the quantity sold. It is estimated that next period selling and administrative costs will be the same as February actual.

Main-Line	$2,000
Co-Line	800
By-Line	36

6. Standard net profit on Co-Line is 10% of sales.
7. No profit or loss is realized on By-Line sales.

Required:

a. Compute the value of the By-Line inventory and the costs transferred from Process #1 to By-Line units during the period.

b. Compute the value of the Co-Line inventory and the costs transferred from Process #1 to Co-Line units during the period.

c. Copy and complete the following entries:

1. Process 1
   Process 2
   Process 3
      Raw Material & Various
2. Process 2
   Process 3
   By-Line Inventory
      Process 1
3. Finished Goods—Main-Line
      Process 2
4. Finished Goods—Co-Line
      Process 3

5. Cash
   Sales—Main Line
   Cost of Goods Sold—Main-Line
   Finished Goods—Main-Line
6. Cash
   Sales—Co-Line
   Cost of Goods Sold—Co-Line
   Finished Goods—Co-Line
7. Cash
   By-Line Inventory
   Selling & Administrative Expenses

d. Copy and complete the following Income Statement:

	Main-Line	*Co-Line*	*By-Line*	*Total*
Sales				
Cost of Goods Sold				
Gross Profit				
Selling & Administrative Expenses				
Net Profit				

Number 5

From the following information concerning the City of Langdon, you are to prepare as of December 31, 1958:

a. A worksheet reflecting the transactions, closing entries and balance sheet for its general fund.
b. A statement of operations for its working capital fund.
c. A balance sheet for its working capital fund.

The accounts of the general fund as of January 1, 1958 were as follows:

Cash	$1,000
Taxes Receivable—Delinquent	8,000
Accounts Payable	7,000
Reserve for Encumbrances	1,500
Unappropriated Surplus	500

The following transactions for the current year are to be considered:

1. The budget which was adopted for 1958 provided for taxes of $275,000, special assessments of $100,000, fees of $15,000, and license revenues of $10,000. Appropriations were $290,000 for general fund operations, and $100,000 for the purpose of establishing a working capital fund.
2. All taxes and special assessments became receivable.
3. Cash receipts for the general fund included:

Taxes from 1958	$260,000
Special assessments	100,000
Fees	16,000
Licenses	9,500
Taxes Receivable—Delinquent plus interest of $500. Tax liens were obtained on the remainder of the delinquent taxes	5,500

4. Contracts amounting to $75,000 were let by the general fund.

5. Services rendered by the working capital fund to other departments included: General fund, $40,000; Utility fund, $20,000 of which $5,000 remained uncollected at the end of the year.

6. The following cash disbursements were made by the general fund:

Working capital fund	$100,000
Accounts payable of the preceding year	7,000
Outstanding orders at beginning of year were all received and paid for	2,000
Expenses of fund incurred during year	145,000
Stores purchased for central storeroom established during year	5,000
Contracts let during year	30,000
Permanent advance to newly created petty cash fund	1,000
Services performed by working capital fund	35,000
Salaries paid during year	30,000

7. The following cash disbursements were made by the working capital fund:

Purchase of equipment (Estimated useful life 10 yrs.)	$60,000
Purchase of materials and supplies of which 1/5 remained at end of year	40,000
Salaries and wages as follows:	
Direct labor	9,000
Office salaries	2,000
Superintendent's salary	4,000
Heat, Light & Power	2,000
Office expenses	500

8. All unpaid taxes become delinquent.

9. Stores inventory in general fund amounted to $2,000 on December 31, 1958.

EXAMINATION IN ACCOUNTING PRACTICE—PART II

May 14, 1959; 1:30 to 6:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—20 to 25 minutes)

The Y & P Music Company, a Washington corporation, operates two retail music stores, one located in Seattle, Washington and the other in Tacoma, Washington. Each store maintains a separate set of accounting records; intercompany transfers or transactions are recorded in an intercompany account carried on each set of records.

Purchases of major items of inventory, such as organs and pianos, are made under a financial arrangement with a local bank advancing 90% of the invoice price and the company paying 10%. If the bank note remains unpaid at the end of 90 days the company is required to pay an additional 10% of the invoice price as a payment on the note.

In August 1956, the Seattle store purchased an organ for which the seller's draft in the amount of $6,300 was sent to The First National Bank of Seattle, which refused to finance the purchase of the instrument. Arrangements were made through the Tacoma store with The Citizens Bank of Tacoma to provide the financing. The bank lent Tacoma 90% of the invoice price, or $5,670 which Tacoma deposited and credited to notes payable. The Seattle store drew a check payable to the Tacoma store for $630, or 10% of the invoice price, charging Tacoma intercompany account on its books. Tacoma took up the deposit crediting the intercompany account carried with Seattle.

Tacoma, using the 10% received from Seattle and the 90% advanced by the bank, drew a check payable to The First National Bank of Seattle in full payment of the draft, charging notes payable.

In November, Seattle made the second payment of $630 directly to the Tacoma bank, charging Tacoma intercompany account, and also notified the Tacoma bookkeeper that the payment had been made. Tacoma took up the transaction charging organ purchases and crediting Seattle. In December Seattle paid off the balance on the note charging organ purchases.

Required:

Adjusting entries to be recorded on each set of books correcting the account balances.

Number 2 (Estimated time—60 to 80 minutes)

The Claxton Machine Co., Inc. maintains and supplies the raw materials for machines which it rents out on one-year contracts. The charge for service and supplies is billed monthly and is based on usage, $8 for each 100 units as measured by meters with a minimum monthly charge of $160 per machine.

The company, whose fiscal year ends on June 30, applied to a bank in May 1959 for a loan of $12,000 with 6% interest payable quarterly. The company expects to buy 10 more machines with the proceeds. The controller believes that, because of the increasing popularity of its machines and the additional revenue from the new machines, one-half the loan could be repaid out of profits in six months. The bank is skeptical of the conclusion reached from the data submitted. There is doubt that the company will have sufficient cash to pay its bills promptly. The loan officer of the bank proposes that the company borrow $6,000 from Mr. Claxton, the president of the company, subordinating that loan to the bank loan. The bank loan will be made on July 1 if it is awarded.

While Mr. Claxton could obtain the $6,000, he does not believe it is needed. He engages you to prepare a statement from his data. The statement is to be based on the assumption that the loan is granted, the machines purchased and paid for on July 1, and that they are placed in operation on August 1. The statement should show the amount of working capital, if any, in addition to the $12,000 loan, which will be required during each of the next six months.

The company's estimated balance sheet at June 30, 1959 is as follows:

ASSETS

Cash		$ 511
Accounts receivable	$ 4,800	
Less allowances for losses	240	4,560
Inventory of raw material, 980 gallons		980
20 machines at cost	22,000	
Less depreciation accumulated at 10% per year on a monthly basis	6,000	16,000
		$22,051

LIABILITIES

Accounts payable for raw material purchases	$ 1,930
Federal income tax—current	1,200
Other current liabilities	400
Common stock	10,000
Retained earnings	8,521
	$22,051

The following explanations and data are to be considered:

(1) The machines are delivered dismantled. The company pays a machine shop $60 each to assemble them.

(2) Supplementary fixtures must be provided at each installation. These cost $45 each. The fixtures will last 5 years.

(3) Since it is more convenient for the customers to have the machines installed during non-business hours, employees may install them during overtime hours, which will increase the payroll an estimated $300.

(4) Meter readings are estimated as follows:

	1,500 Units	*2,000 Units*	*2,500 Units*	*3,000 Units*	*3,500 Units*	*Total No. of Machines*
July	4	2	6	8		20
Aug.	2	6	10	12		30
Sept.		2	8	10	10	30
Oct.			4	10	16	30
Nov.			4	10	16	30
Dec.			4	10	16	30
Jan.				10	20	30

(5) Billing is made at the end of each month, but it takes about a week to prepare the bills. Past experience has been that half the bills will be paid in the month following billing and the remainder that are collectible will be paid within the second month. It is estimated that losses on accounts receivable will amount to $50 per month. The June 30th balance of receivables includes $3,600 from June billings.

(6) Each 100 units requires 4 gallons of raw material. Savings on bulk purchases make it advisable to order only twice a month. They may rely on deliveries within half a month after the order is placed. This means the ending inventory each month must be enough to take care of half the total material requirements of the following month. Terms are $1 per gallon due N/10, E.O.M.

(7) A monthly average of other operating expenses was prepared from the cash disbursements book and submitted to you with notes on how they will be changed as follows:

a. Salaries for machine service and maintenance	$800
b. Maintenance supplies	60
c. General shop expense, sales promotion and general administration	560

Notes on Expected Changes

Item a. Increase proportionate to increase in number of machines.

Item b. The expense for a new machine will be half the expense for an old machine.

Item c. Increase 10% for the six months.

(8) The bank requires that a minimum balance of $500 be maintained during the period of the loan.

(9) Your fee of $400 will be billed in July.

(10) To simplify computations for immaterial items, it is agreed that:

a. The employer's share of taxes based on payroll shall be computed at the rate of 4% and be paid currently with the payroll. Taxes to be withheld from employees are also to be paid currently with the payrolls.

b. There is no state tax based on income. The federal income taxes will be paid in equal installments in September and December.

c. The amount of "other current liabilities" will remain constant at $400.

GROUP II

(Estimated time—120 to 165 minutes)

(Solve only three problems in this group. If four are solved, only the first three will be considered.)

Number 3

Mrs. A and Mrs. B operate a skating rink as a partnership, sharing profits equally. They manage the business themselves, employing high school students for ticket takers and skate boys. Income is from admissions, skate rentals, and sales of soft drinks and candy, some of which is sold on credit.

The business records consist of a single entry cash book in which the details of all cash receipts and disbursements are entered. The business fiscal year ends on March 31.

The balance sheet of the partnership at March 31, 1958 was as follows:

ASSETS

Cash on hand and in bank	$1,295
Accounts receivable	86
Inventory (soft drinks and candy)	119
Prepaid insurance	270
Land	500
Building and building improvements	6,628
Equipment	2,522
Accumulated depreciation	(5,476)
	$5,944

LIABILITIES AND PARTNERS' CAPITAL

Accounts payable	$ 882
Taxes payable (including $38 withheld from employees)	208
Capital—Mrs. A	2,427
Capital—Mrs. B	2,427
	$5,944

The summary of the cash book for the year ended March 31, 1959 is as follows:

	Debit	Credit
Admissions		$4,817
City admissions tax collected		231
Skate rentals		1,899
Sales—Soft drinks and candy		3,112
State sales tax collected		56
Wages paid	$ 696	
Purchased—Soft drinks and candy	2,434	
Insurance expense	750	
Heat, fuel, and telephone	579	
Supplies	309	
Payroll taxes paid	142	
City admissions tax paid	239	
State sales and excise taxes paid	179	
Property taxes paid	74	
Equipment repairs	260	
Building repairs and improvements	2,914	
Miscellaneous expense	199	
Drawings—Mrs. A	1,434	
Drawings—Mrs. B	840	

The following balances at March 31, 1959 were furnished by the client and are assumed to be correct:

Cash on hand	$ 55
Inventory	108
Accounts receivable	15
Amounts withheld from employees	16

The details of accounts payable and taxes payable were as follows:

	March 31	
	1958	1959
Accounts payable—		
Merchandise	$160	$ 71
Heat, fuel, and telephone	63	43
Supplies	32	14
Building repairs and improvements	540	
Equipment repairs	56	16
Miscellaneous	31	5
	$882	$149

	March 31	
	1958	1959
Taxes payable—		
Payroll taxes (including amounts withheld from employees)	$ 72	$ 23
City admissions tax	39	31
State sales and excise taxes	23	16
Property taxes	74	147
	$208	$217

A review of cash transactions revealed the following:

1. In accordance with established policy of purchasing insurance covering one-year periods, the following purchases were made during the year ended March 31, 1959:

Fire insurance, policy expires August 1, 1959		$144
Liability insurance, policy expires October 15, 1959		360
Fire and liability insurance on partners' homes and automobiles, policies expire June 30, 1959—		
Mrs. A	$110	
Mrs. B	136	246
		$750

2. Depreciation is computed on a straight-line basis over a 20-year period for building, 5 years for building improvements, and various rates for the equipment. One-half year's depreciation is taken in year of acquisition. Based on the asset balances at the beginning of the year, depreciation expense for the year would be $817. No fixed assets were disposed of during the year.

3. Building repairs and improvements include $1,898 in full payment of a city assessment for paving streets and alleys in the area, $560 for painting the exterior of the building, and the balance for normal building maintenance.

4. During the year $62 was withheld from employees' wages for social security and withholding taxes.

Required:

a. A worksheet showing:
   (1) adjustments to the beginning balance sheet and to the income and expense accounts.
   (2) the financial position of the partnership at March 31, 1959, and
   (3) the results of its operations for the year then ended on the accrual basis.

b. The entries in journal form to adjust the accounts, including entries necessary to place the books on an accrual basis. Give brief explanations for each adjustment, and key the journal form adjustments to the adjustments in the worksheet.

Number 4

The XYZ Company keeps its books and files its income tax returns on the accrual basis. The company has asked you to determine as near as possible the amount of cash which would be required on March 15, 1959, to pay the amount due on the income tax liability for the calendar year 1958.

The company's operation involves the purchase and resale of machine parts. No manufacturing is done.

Your examination of the 1957 income tax return resulted in the following information:

All assets had the same basis for book and tax purposes.

Bad debts are deducted on the reserve method.

There is an unused capital loss carry-over to 1958 of $1,300.

You have obtained the following information regarding the operations of the company for 1958:

Balance Sheets

	December 31, 1957 Debit	December 31, 1957 Credit	December 31, 1958 Debit	December 31, 1958 Credit
Cash	$ 111,000		$ 132,000	
Accounts receivable	314,000		337,000	
Reserve for bad debts		$ 12,000		$ 13,000
Reserve for cash discounts		6,000		4,500
Inventory	626,000		657,000	
Reserve for future inventory price decline				12,000
Investments	157,000		147,000	
Cash surrender value of officers life insurance	18,500		21,000	
Fixed assets	602,800		681,400	
Reserve for depreciation		203,400		291,900
Accounts payable		167,000		133,000
Accrued salaries and wages		72,000		68,000
Accrued federal income taxes		220,000		186,000
Reserve for lawsuit		—		80,000
Capital stock		400,000		400,000
Retained earnings		780,900		787,000
Treasury stock	32,000		—	
Totals	$1,861,300	$1,861,300	$1,975,400	$1,975,400

Income Statement

Year Ended December 31, 1958

Sales		$2,089,600
Less—Cost of goods sold (including $12,000 provision for inventory price decline)		1,298,000
		791,600
Selling and general and administrative expenses—		
Salaries and wages	$284,400	
Heat, light, water, etc.	41,000	
Depreciation	93,400	
Repairs	28,700	
Advertising	3,300	
Bad debt expense	1,000	
Officers' life insurance (net)	2,300	
Supplies	51,200	
Miscellaneous	21,800	527,100
Net profit from operations		264,500
Other income		11,000
Profit before taxes		275,500
Provision for federal income taxes		150,000
Net profit		$ 125,500

Retained Earnings
Year Ended December 31, 1958

Balance January 1, 1958		$780,900
Add—Net profit for the year	$125,500	
Gain on parking lot condemned for expressway, such property not to be replaced	16,600	142,100
		923,000
Deduct—Cash dividends paid	50,000	
Provision for lawsuit	80,000	
Loss on sale of treasury stock	6,000	136,000
Balance December 31, 1958		$787,000

The treasury stock sold during the year was purchased August 5, 1952 for $32,000 and sold December 5, 1958 for $26,000. The condemned parking lot was purchased February 6, 1938 for $9,000 and sold June 12, 1958 for $25,600.

An analysis of accrued federal income taxes showed the following transactions for the year:

Balance, December 31, 1957		$220,000
Provision		150,000
		370,000
Payments—		
1957 tax	$160,000	
Additional assessment for 1955 (including $1,800 interest)	16,000	
1958 declaration	8,000	184,000
Balance, December 31, 1958		$186,000

Other income included the following:

Dividends from domestic corporations	$ 6,000
Iowa highway bond interest	1,100
Outstanding payroll checks written off	500
U. S. Savings bond interest	600
Chicago school bond interest	400
Gain on sale of assets	2,400
Total	$ 11,000

The $2,400 gain on sale of assets resulted from the following dispositions during the year:

	Gain or (Loss)
Assets held for more than six months—	
Mailing machine	$ (400)
1955 Ford (Net depreciated cost $900—trade-in allowance on January 2, 1958, $1,100; all automobiles are depreciated at 20% per year)	200
100 shares Brown Co. common stock	3,200
Assets held for less than six months—	
50 shares Jones, Inc. common stock	(500)
Bookkeeping machine	(100)

Required:

A schedule showing the calculation of the federal income tax, the balance of tax due, and the cash required March 15, 1959.

Number 5

The Smith Company, Inc. went through a quasi-reorganization as of December 31, 1957 eliminating the deficit in earned surplus and reducing the value of fixed assets from $900,000 to their appraised replacement value of $700,000. No adjustment of the reserve for depreciation was required.

During 1958, the Company sold $300,000 principal amount of First Mortgage Bonds. The indenture securing these bonds provides that "the Company shall not declare or pay any dividends unless, immediately after giving effect to such action, the aggregate amount declared or paid as dividends subsequent to December 31, 1957 will not be more than the net income of the Company earned subsequent to December 31, 1957." The indenture's definition of net income contains a provision that the depreciation deductions shall be the larger of the amount actually deducted on the books of the Company or the amount claimed for federal income tax purposes.

Net income for 1958, before provisions for depreciation and federal income tax, amounted to $85,000 for both book and tax purposes. The estimated remaining life of fixed assets is 20 years from December 31, 1957 and net basis is to be written off at straight-line rates for book and tax purposes. The Company declared and paid dividends on common stock aggregating $25,000 on December 31, 1958.

A summary balance sheet immediately prior to reorganization as of December 31, 1957 is presented below.

Summary Balance Sheet—December 31, 1957

(Prior to Reorganization)

Assets		*Net Worth*	
Net working capital	$ 50,000	Common stock	$600,000
Fixed assets	900,000	Paid-in surplus	500,000
Reserve for depreciation	(100,000)	Earned surplus (deficit)	(250,000)
	$850,000		$850,000

The deficit in earned surplus is due to losses for book and tax purposes amounting to $70,000, $40,000, $50,000, $60,000 and $30,000 for the years 1953 through 1957 respectively. The Company was incorporated January 1, 1953.

Required:

a. Summary balance sheet for book purposes as of December 31, 1958.
b. Net taxable income for federal income tax purposes for 1958.
c. Carry-forward losses for federal income tax purposes available as a reduction of 1958 and 1959 taxable income.
d. Percentage of common stock dividend taxable to recipients.

Number 6

The Self-Service Drug Company is a retail drug store which is operated by Mr. Smith as a sole proprietorship. Mr. Smith carries a business interruption insurance policy on his store, the pertinent details and provisions of which are as follows:

Amount of insurance carried	$40,000
Co-Insurance Clause	80%

Risks Covered—Fire and Extended Coverage.
Type of Policy—Single Item Gross Earnings Form for Mercantile Risks.

The important clauses are as follows:

1. Recovery in the event of loss hereunder shall be the Actual Loss Sustained by the Insured directly resulting from such interruption of business, but not exceeding the reduction in gross earnings less charges and expenses which do not necessarily continue during the interruption of business.

2. Gross Earnings: For the purposes of this insurance "Gross Earnings" are defined as the sum of:

(a) Total net sales, less any expense items eliminated entirely by loss of sales and directly applicable thereto, and
(b) Other earnings derived from operation of the business,
less the cost of:
(c) Merchandise sold, including packaging materials therefor, exclusive of purchase discounts,
(d) Materials and supplies consumed directly in service(s) sold, and
(e) Service(s) purchased from outsiders (not employees of the Insured) for resale which do not continue under contract.

No other costs shall be deducted in determining "Gross Earnings."

3. Contribution Clause: In consideration of the rate and form under which this policy is written, this Company shall be liable, in the event of loss, for no greater proportion thereof than the amount hereby covered bears to 80% of the gross earnings that would have been earned (had no loss occurred) during the 12 months immediately following the date of damage to or destruction of the described property.

4. Expense to Reduce Loss: This policy also covers such expenses as are necessarily incurred for the purpose of reducing any loss under this policy (except expense incurred to extinguish a fire), not exceeding, however, the amount by which the loss under this policy is thereby reduced. Such expenses shall not be subject to the application of the Contribution Clause.

On the morning of March 1, 1958, before the store was opened for business for the day, the assured's store was damaged by fire. As a result thereof, it was necessary to discontinue business until the store could be repaired and repainted and new stock ordered and received to replace that damaged or destroyed. All equipment and furnishings in the store were not damaged beyond repair. In order to resume operations as soon as possible, thereby reducing the loss sustained, the assured in repairing the building and restocking the store incurred the following expenses with the approval of the insurance company. The co-insurance clause does not apply to these expenses.

Overtime premium paid to construction workers in repairing and building	$425
Additional costs to restock merchandise:	
Long-distance telephone calls	35
Air freight (excess over regular method of shipping)	230

The assured opened his store for business on April 1, 1958. All repairs had been completed and all the replacement stock had been received by this date, thereby limiting the loss period to one month.

As the assured's auditor you are engaged to compute the amount of the claim that is payable under the terms of this policy.

The statement of income and expense for the calendar year 1957 is as follows:

Sales		$160,000
Cost of goods sold:		
Inventory—Beginning of year	$ 37,230	
Merchandise purchases	110,100	
Freight and express in	530	
Total	147,860	
Less: Inventory—End of year	43,860	
Cost of goods sold		104,000
Gross profit		56,000
Operating expenses:		
Salaries and wages	23,000	
Rent	3,600	
Taxes—F.I.C.A. and Unemployment	920	
Taxes—Other	1,000	
Bad debts	400	
Bad checks	100	
Depreciation	3,560	
Delivery truck expense	280	
Insurance	1,698	
Advertising	2,042	
Wrapping materials	300	
Other supplies and repairs	1,500	
Sales discounts	1,040	
Other operating expenses	5,000	
Total operating expenses		44,440
Net operating income		11,560
Add: Other income:		
Purchase discounts	840	
Interest on savings accounts	200	1,040
Net income		$ 12,600

During the course of this engagement you established the following facts:

1. The sales volume is consistent from month to month throughout the year and no increase or decrease in sales is anticipated subsequent to the fire. As a result of price changes initiated in January, 1958, the gross profit on sales was

increased by 2% and such gross earnings are consistent from month to month.

2. During the loss period all employees were paid their regular monthly salaries. However, normal overtime on all employees of about $100 per month was saved. During the loss period all of the employees were able to take their annual two-weeks vacation.

3. Under the terms of the lease the rent on the building of $300 per month was discontinued for the loss period.

4. As a result of not being open for business, advertising costs were about ½ of the normal amount spent for this purpose.

5. All other costs not directly related to sales continued 100%. (Had the loss period been longer some of these items likely would have been discontinued.)

Required:

a. Amount of insurance required based on 80% co-insurance clause.

b. Amount of loss sustained which is subject to a possible co-insurance penalty.

c. Total amount to be received by the assured under the terms of the policy.

Show all details of computations and state any assumptions that you have made in answering this problem. Disregard pennies in computations and compute percentages to two places (Ex. 50.45%).

EXAMINATION IN AUDITING

May 14, 1959; 8:30 a.m. to 12:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—20 to 30 minutes)

On the answer sheet provided you are to enter an "X" in the proper column for each of the 50 items.

a. The following conditions have been officially or generally recognized as bringing the independence of an "independent" certified public accountant into question.

1. Ownership of 1% of a client corporation's outstanding stock.
2. Ownership of such stock amounting to 1% of accountant's personal fortune.
3. Membership on client's board of directors.
4. Service on Community Chest Board with president of client corporation.
5. Authorship of articles describing auditing problems in industry of which your client is an important part. Knowledge of the industry was obtained while serving as auditor for a former client who is in competition with your present client.
6. Occupancy of important administrative post in subsidiary corporation with close financial affiliation with your client.
7. Accounting practice consists largely or wholly of client and its subsidiaries.

b. The following practices are generally considered to be unethical by certified public accountants.

8. Employment of a former employee of a fellow practitioner.
9. Use of a 3″ x 5″ "card" in a newspaper announcing a change of address.
10. Solicitation through the mail of a firm known not to have an accountant. There is no personal relationship between the accountant and the addressee.
11. Solicitation through the mail of a known client of another practitioner, but in connection with a type of work the other practitioner has positively stated he will not perform.
12. Use of the sub-head on letterheads reading "Members of State Society of CPAs" when all members of the accounting firm are members of the professional organization.
13. Allowance of 2½% share of fees from work referred by a local banker.
14. Disclosure to a close personal friend of the earnings of a client corporation as shown on a report to be published in the near future.
15. Disclosure to a friend who is a stockholder of the corporation you audited that the book values of fixed assets are considerably less than the appraised values. This specific information appeared in the financial statement published last month.

c. Each of the following procedures would detect "kiting" between bank accounts to cover a cash shortage on the balance sheet date.

16. Correspondence with banks by which bank balance shown on books at balance sheet date was confirmed.
17. Correspondence with banks in order to confirm deposits, and comparison of deposit slips with bank's records, for last month prior to balance sheet date.
18. Reconciliation of all bank accounts fifteen days after balance sheet date.

d. The following procedures are ordinarily essential to the issuance of an unqualified opinion on financial statements when material amounts are involved.

19. Reconciliation of all bank accounts of material amounts to the balance sheet date.
20. Count of all cash on hand at balance sheet date.
21. Confirmation of all receivables by direct communication at some date during the year under audit.
22. Physical examination of a substantial part of stocks and bonds in safety deposit vaults.
23. Observation of the physical count of a fair sample of inventory.
24. On first audit of client corporation six years after organization investigation as to whether fixed assets were originally acquired for cash, stock, or other assets.
25. Examination of fire insurance policies which are in effect.
26. Determination of "market" value of high-valued items in stock-in-trade.
27. Determination of replacement cost of important items in fixed assets.
28. Direct confirmation by correspondence of all current liabilities.
29. Direct confirmation of oustanding preferred stock by correspondence with a registrar and transfer agent, where records are kept by such person(s).
30. Direct confirmation by correspondence from New York Stock Exchange of market value of listed stock on balance sheet date.

e. The following phrases and statements refer to matters as to which auditors are generally in agreement.

31. That management services should be performed by an independent CPA as a part of his regular practice.
32. Quotation and collection of a fee contingent on the results obtained in a federal income tax case is considered to be unethical.
33. Unsigned financial statements on plain paper may be used.
34. Deduction of net mark-downs below the cost-retail computation line in retail method inventories.
35. Investigate internal control procedures by testing and sampling transactions.
36. Inclusion of discount on bonds payable among the assets of a company.
37. Inclusion of inventories of office supplies under a non-current asset heading.
38. Use of the term "retained earnings" as the equivalent of "earned surplus."
39. There should be no qualification of the short-form report when receivables from the government in substantial amount cannot be confirmed by direct

communication but other procedures reveal the validity of the claim.

40. Inclusion in consolidated surplus of the parent's share of subsidiary's undistributed net earnings, so labeled, since date of acquisition of subsidiary's stock by parent.
41. Depreciation should not necessarily be the same for both income tax and financial statement purposes.
42. Practically all methods of valuing inventory in the balance sheet, except cost, are subject to the general rule of "lower of cost or market."
43. When a business combination is deemed to be a pooling of interest, a new basis of accountability does not arise.
44. Disclosing "market" values of investment securities owned, shown at cost on the balance sheet, where there is a substantial difference.
45. The independent auditor can accept work performed by internal audit staff, when a high degree of internal control is in evidence.

f. The following statements pertain to the opinion rendered by an independent certified public accountant.

46. A certificate unqualified in the opinion paragraph should be rendered when you did not confirm receivables from governmental agencies if these receivables constituted 25% of current assets and 12% of total assets, but you did satisfy yourself regarding their validity by some alternative procedure.
47. An unqualified opinion should be rendered if during the year the client changed the method of computing depreciation on new additions from the straight-line method to the sum-of-the-digits method; the effect on net income for the year was material. The change was explained by means of a footnote.
48. You should disclaim an opinion if the engagement was undertaken after the balance sheet date, because on the balance sheet date the client had not taken its physical inventory of a material amount. You were, therefore, unable to witness the physical inventory. Your other procedures were limited to tests of prices, extensions and footings. These disclosed only insignificant differences from the book figures for inventory.
49. You should qualify as to consistency in the opinion paragraph if at the beginning of the year the company changed the basis of computing the cost of its principal raw material from the average cost basis to the last-in, first-out basis; as a result income for the year was reduced 50%.
50. You should render a qualified opinion if under the terms of the engagement, you did not witness the physical inventory, but were given a copy of the client's counts, certified by the president; this was tested and found to be substantially correct; the inventory constituted 35% of current assets and 20% of total assets.

Number 2 (Estimated time—20 to 30 minutes)

For several years you have made the annual audit for the Edgemont Company. This company is *not* a dealer in securities. A list of securities presently held is kept but an investment register is not maintained. When making the examination, the following worksheet was prepared.

Column Number	Column Heading
1	*Description of Security* (name, maturity, rate, etc.)
	Balance at Beginning of Year
2	Face value or number of shares
3	Cost or book value
	Additions during Period
4	Date
5	Face value or number of shares
6	Cost
	Deductions during Period
7	Date
8	Face value or number of shares
9	Cost or book value
10	*Proceeds on Disposals* (net)
11	*Profit or (Loss) on Disposals*
	Balance at End of Year
12	Face value or number of shares
13	Cost or book value
14	Market value
	Interest and Dividends
15	Accrued at beginning of year
16	Purchased
17	Earned
18	Received
19	Accrued at end of year

Required:

Draw a line down the middle of a lined sheet(s) of paper.

a. On the left of the line, state the specific source(s) of information to be entered in each column, and where required, how the data of previous columns are combined.

b. On the right of the line, state the principal way(s) that such information would be verified.

Number 3 (Estimated time—20 to 30 minutes)

Your client, ABC Company, is contemplating changing its method of computing depreciation for federal income tax purposes for the calendar year 1958 from a straight-line method to the so-called "sum-of-the-years' digits" method. However, the company has not decided whether it will record on the books the increased depreciation provision. The company provides you with the following data:

Net taxable income before provision for depreciation	$1,000,000
Provision for depreciation:	
Straight-line method	200,000
Sum-of-the-years' digits method	300,000
Amount of income taxes (not yet recorded):	
Based on $700,000	358,500
Based on $800,000	410,500

a. If the sum-of-the-years' digits method for computing depreciation is claimed for federal income tax purposes but straight-line depreciation has been recorded, and will remain unchanged on the books:
   1. Give the journal entries, if any, relating to income taxes which should be recorded on the books.
   2. Prepare the qualifications, if any, which you would include in your audit report. (An opinion paragraph will meet this requirement.)
   3. Prepare the notes to financial statements, if any, which would be needed.

b. If the sum-of-the-years' digits method for computing depreciation is claimed for tax purposes and has been recorded on the books:
   1. Give the journal entries, if any, relating to income taxes which should be recorded on the books.
   2. Prepare the qualifications, if any, which you would include in your audit report. (An opinion paragraph will meet this requirement.)
   3. Prepare the notes to financial statements, if any, which would be needed.

Number 4 (Estimated time—20 to 30 minutes)

You have been making annual audits of the XYZ Sales Company. During the last few years, earnings have shown a slight but steady decline.

At the beginning of this year's audit, you obtain company-prepared financial statements which show a significant increase in earnings for this year over the prior three years. The company is engaged in a wholesaling operation and resells to retailers the products purchased from various manufacturers. There have been no unit price changes in either purchases or sales. The method of operation remains the same so that increased efficiency does not account for the increase in income. The company's other sources of revenue remain the same. In short, the business has been run on the same basis as in the past. In addition, you are aware that management is anxious to present a favorable statement of income since it is facing a struggle for control with a group of stockholders who charge that income has declined due to mismanagement. You conclude that net income may be overstated by understating expired costs and expenses or liabilities, or overstating assets.

The company is on a FIFO inventory basis. A physical inventory was taken at the year end. A tag system was used and all tags were accounted for.

Required:

Draw a line down the middle of a lined sheet(s) of paper.

a. To the left of the line, state the ways that expired costs and expenses or liabilities may have been understated, or assets overstated.
b. To the right of the line, for each item mentioned in part a, outline in a few words the audit steps that would reveal each understatement or overstatement.

GROUP II

(Estimated time—60 to 90 minutes)

(Answer only three questions in this group. If four are answered only the first three will be considered.)

Number 5

You are engaged in the audit as at December 31 of a medium-sized manufacturing company which has between three and four hundred open trade receivable accounts. As a part of the interim work, you decide on October 10 to select approximately one hundred customers' accounts for positive confirmations as of September 30. You obtain an aged trial balance of the accounts receivable as at September 30 and trace the balances of the open accounts to the trial balance from the subsidiary ledgers. In addition, you test the aging, foot the trial balance, and agree the total with the accounts receivable control account in the general ledger. Also, detailed tests of the sales and credit journals are made for the month of September.

Required:

a. Enumerate the types of accounts you would want to include in your selection of accounts to be circularized.
b. Outline the additional audit steps that should be undertaken at December 31 in support of the amounts shown as accounts receivable; the client is preparing for your use an aged trial balance of accounts receivable as of that date.

Number 6

During the month of April, you are engaged to examine the balance sheet of a new client as of March 31. The client manufactures steel castings and forgings. A physical count of all inventories is made at the end of each quarter of the fiscal year and the company adjusts its inventory book amounts to reflect the physical counts. As you were not engaged at the time of the physical inventory on March 31, you request that the company make another physical inventory count at the end of April in order that you may observe and make test counts. The client agrees and another inventory is taken on April 30 which you witness.

Inventories of raw materials, work-in-process and finished goods totaled $125,000 at March 31. Total current assets amounted to $188,000, total current liabilities were $186,000 and total assets were $450,000.

The company maintains perpetual inventory records of raw materials and supplies, but has no job cost system or perpetual records of work-in-process or finished goods. Production records are kept in the plant showing the tons of castings poured each day, and sales records reflect the tons of castings and forgings sold daily to various customers of the company.

Required:

a. What audit procedures would you use to satisfy yourself as to the *quantities* on hand at balance sheet date?

b. Assuming that the results of your tests of inventories are satisfactory, would you issue an audit report unqualified as to opinion and scope of examination in view of the fact that you were not on hand to observe inventories at March 31? Give reasons for your answer. (Limit your discussion to a consideration of the inventory problem.)

Number 7

The Patrick Company had poor internal control over its cash transactions. Facts about its cash position at November 30, 1958 were as follows:

The cash books showed a balance of $18,901.62, which included undeposited receipts. A credit of $100 on the bank's records did not appear on the books of the company. The balance per bank statement was $15,550. Outstanding checks were: No. 62 for $116.25, No. 183 for $150.00, No. 284 for $253.25, No. 8621 for $190.71, No. 8623 for $206.80, and No. 8632 for $145.28.

The cashier abstracted all undeposited receipts in excess of $3,794.41 and prepared the following reconciliation:

Balance, per books, November 30, 1958		$18,901.62
Add: Outstanding checks:		
8621	$190.71	
8623	206.80	
8632	145.28	442.79
		19,344.41
Less: Undeposited receipts		3,794.41
Balance per bank, November 30, 1958		15,550.00
Deduct: Unrecorded credit		100.00
True cash, November 30, 1958		$15,450.00

Required:

a. Prepare a supporting schedule showing how much the cashier abstracted.

b. How did he attempt to conceal his theft?

c. Taking only the information given, name two specific features of internal control which were apparently missing.

d. If the cashier's October 31 reconciliation is known to be in order and you start your audit on December 5, 1958, what specific auditing procedures would uncover the theft?

Number 8

The Professional Men's Association of Middleton is made up of men in the various professions, including CPAs. From the start it has been tax exempt from federal income and excise taxes, other than payroll.

The dues for members are $40 a year, after an initiation fee of $100. The Association has had a consistent policy of operating on a cash basis. It does not deposit initiation fees received with applications and does not consider them as income until the Membership committee has acted thereon. Then the successful applicants' fees are deposited and the unsuccessful applicants' checks are returned to them.

The fiscal year ends August 31. Each year the directors choose from the membership a CPA to make a thorough audit; and no one is allowed to audit two consecutive years. This year you have been selected for the first time, but you are solemnly warned that the directors will not tolerate any suggestion of putting the accounts on an accrual basis. You accept. An adequate fee is provided.

The secretary furnishes you with the following information:

Membership at September 1, 1957			2,980
Elected during year		123	
Dropped for non-payment of dues	15		
Died	37		
Expelled	1	53	
Net gain			70

Your examination of records shows the following:

Notices that "dues are due" are sent out in August. Dues for a full year, not to be prorated, must be paid when elected to membership. Prior to the end of the preceding fiscal year 410 members had paid their dues and in the current fiscal year 457 members had paid their dues for the year beginning September 1, 1958. One of these had died very suddenly on August 30 and is included in the 37 above. No refunds are made for deaths taking place after the fiscal year begins, however refunds of one-half the dues are made to expelled members. There were 36 applications pending at the end of the fiscal year. During the course of your audit, the committee met and approved of 34. You further find that at the *beginning* of the year there were 47 such applications and that 45 had been acted upon favorably and are included in the 123 above.

The directors are interested in learning if there is a substantial difference between the income from dues on a cash basis as compared to the accrual basis.

Required:

a. Prepare a schedule of income from membership showing:
   1. Changes in members
   2. Income from initiation fees
   3. Income from dues for the year, accrual basis
   4. Income from dues for the year, cash basis
   5. Total income from membership
   6. Reconciliation of the income from dues cash basis to the accrual basis

b. What other audit procedures would you use to verify the income from membership? Give reasons.

EXAMINATION IN COMMERCIAL LAW

May 15, 1959; 8:30 a.m. to 12:00 p.m.

GROUP I

(Answer all six questions in this group)

Number 1 (Estimated time—7 to 10 minutes)

On your paper you are to write in a vertical column the numbers 1 to 10 to represent the ten definitions and statements set forth herein. Opposite each number, and to its right, you are to write the capital letter representing that one of the twenty possible descriptive terms (lettered A to T) which you decide fits the particular definition or statement.

Grades will be based on the number of correct selections. Reasons are not to be given.

Definitions and Statements

1. A person appointed by a court to settle the estate and distribute the property of a decedent who failed to leave a will.

2. A principle barring a person whose legal position is based on prior conduct from changing such position to the legal detriment of one who has rightfully relied on such prior conduct.

3. That mutual legal relationship in contract law which partners have to each other by virtue of being promisees and promisors.

4. False swearing upon an oath properly administered in some judicial proceeding.

5. A person named in a will by the testator with power to settle the decedent's estate and dispose of it according to the terms of the will.

6. The conduct which equity considers neglect to assert one's rights, or failure to do what by law a person should have done, and which neglect or failure constitutes an equitable defense for another party.

7. A fixed sum agreed upon between parties to a contract to be paid as ascertained damages by the party breaching the contract.

8. One who in performing work or services for others exercises his own judgment as to the means to be used to accomplish the result, is free from control or orders from any other person, and is responsible only under his contract for the result obtained.

9. The equitable principle whereby one person is substituted legally in another's place, either as a creditor or as the possessor of any other lawful right, with the effect that the substituted person succeeds to the rights, remedies or proceeds of the claim.

10. A rule under which one entitled to recover damages for breach of contract is obligated to avoid increasing or enhancing such damages.

Possible Descriptive Terms

A. Perjury	K. Probate
B. Fraud	L. Factor
C. Exemplary Damages	M. Laches
D. Executor	N. Independent Contractor
E. Novation	O. Bailment
F. Liquidated Damages	P. Subrogation
G. Estoppel	Q. Nonfeasance
H. Administrator	R. Surety
I. Statute of Limitations	S. Mitigation of Damages
J. Privity	T. Third Party Beneficiary

Number 2 (Estimated time—10 to 15 minutes)

a. Define a partnership.

b. In 1954 Adams, owner of the Octagonal Building, by written agreement leased a store for the period of ten years to the partnership of Meehan and Platt at an annual rental of $5,000 plus 2% of the annual profits of Meehan and Platt in excess of $50,000. Four years later a creditor of the partnership brought suit for nonpayment of a past due contractual obligation of the firm and named as parties defendant Meehan, Platt and Adams as partners. The creditor included Adams as a party solely on the alleged ground that the *Uniform Partnership Act* provides that in determining whether a partnership exists the receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner.
  1. Does the *Uniform Partnership Act* contain the stated provision?
  2. Under the *Act* is there justification for considering, under the stated facts, that there was *prima facie* evidence that Adams was a partner? Explain.

Number 3 (Estimated time—15 to 20 minutes)

a. Must a notice of dishonor be in writing? Explain.

b. What is requisite as to the actual wording of the notice?

c. When a negotiable instrument is dishonored and delay in giving notice of dishonor is not excused by law, within what periods of time must notice of dishonor be given when the person giving and the person to receive notice reside in the same place?

Number 4 (Estimated time—16 to 25 minutes)

a. The X Warehouse issued a negotiable document of title to Jackson under the terms of which the covered goods were to be delivered to the bearer of the document. Jackson indorsed the instrument to himself. He then negotiated it for value to Everett by delivery only. Everett demanded the goods from the X Warehouse. The latter refused to honor his demand based on the instrument on the ground that negotiation by Jackson to be effective should have been by indorsement.

1. Is the contention of the X Warehouse correct? Explain.
2. Has Everett any related right against Jackson? Explain.

b. State the rights acquired by a person to whom a negotiable document of title has been duly negotiated.

c. Stevens became the owner of a negotiable document of title under which the bailee, Henderson, who issued it, undertook to deliver the goods to the order of Stevens. Stevens negotiated the document for value to Jennings by indorsement and Jennings negotiated it similarly for value to Smith. Thereafter, on demand, Henderson failed to deliver the goods to Smith. Smith thereupon brought action against the prior indorser, Jennings, on the ground that the latter's indorsement made him liable for Henderson's failure to perform his obligation.

Did Smith have a valid cause of action on Jenning's indorsement? Explain.

Number 5 (Estimated time—16 to 25 minutes)

Black, a customer of the White Fur Company, owed money to the company on several separate transactions. All these items were past due, and the oldest one in point of time had been outlawed by the statute of limitations. Black, who had on occasion been making payments on account and specifying that certain past due accounts should be credited (but never the outlawed account), made another part payment but omitted to specify which particular account or accounts should be credited. The White Fur Company thereupon applied the payment to the outlawed account, and then sought to enforce payment of the balance on said account by suit, claiming that the part payment constituted a new promise to pay the balance of the outlawed debt and started the statute of limitations running again.

a. Did the White Fur Company have a right to apply the payment on account to the outlawed claim? Explain.

b. Would the application of the part payment to the outlawed debt, if such application could be legally made, constitute a new promise to pay the balance which would remove the barrier of the statute of limitations and start it running again? Explain.

Number 6 (Estimated time—16 to 25 minutes)

a. Davis and The Excelsior Corporation entered into a written bilateral contract under which the corporation was to perform its promise at a date six months later and thereupon Davis was to pay the corporation $5,000. The promise by the corporation called for performance of an *ultra vires* act. On the due date the corporation refused to perform according to agreement. Davis, willing to perform, brought suit for breach of contract and the corporation entered a defense that the contract was unenforceable because it involved an *ultra vires* act.

Was the corporation's defense good? Explain.

b. Assume the same facts, except that both the corporation and Davis performed fully, that Davis, alleging the *ultra vires* nature of the agreement, brought suit to rescind it and restore the parties to their original positions and that the corporation entered a defense contending that the completed *ultra vires* contract could not be rescinded.

Was the corporation's defense good? Explain.

c. Hazard was employed by the Metropolitan Department Store as driver of one of its light delivery trucks. Under the terms of his employment he made deliveries daily along a designated route and brought the truck back to the store's garage for over-night storage. One day, at the completion of his regular round of deliveries, instead of returning to the garage as required, he drove the truck twenty miles north of the area he habitually covered, expecting to attend a social function unrelated to his employment or to his employer's affairs, and through his negligence in operating the truck seriously injured Brunt in an accident in which Hazard was wholly and solely at fault. Brunt entered suit in tort against the store for damages for personal injuries, alleging that the store was, as principal, responsible for the tortious acts of its agent.

Did Brunt have a valid cause of action against the Metropolitan Department Store? Explain.

GROUP II

(Estimated time 60 to 90 minutes)

(Answer three of the following four questions. If all four are answered, only the first three will be considered.)

Number 7

Alexander sold goods to Davenport on credit terms and shipped them to the buyer in Peoria via the Red Line Express. These facts are basic as to parts a, b and c that follow in which differing additional facts are presented.

a. At Peoria the buyer refused to accept delivery from the carrier. The carrier notified Alexander, the shipper, of rejection of delivery and attempted to return the goods to the shipper. Alexander refused to accept them and they remained in the possession of the carrier. Four days later, having learned that Davenport had become insolvent, Alexander sought to exercise the right of an unpaid seller who has parted with possession of the goods to stop them in transit.

Under the facts stated, were the goods still "in transit"? Explain.

b. Fifty miles before reaching Peoria, the carrier's truck stopped at one of the Red Line Express intermediate depots. At this depot a duly authorized agent of Davenport, the buyer, requested delivery and the carrier made delivery to the buyer's agent at that point. Meanwhile Alexander, the shipper, learned that (1) Davenport was insolvent and (2) delivery had been made to the buyer's agent at the intermediate point. Alexander thereupon sought as an unpaid seller to regain possession of the goods from the buyer's agent on the ground that they could still be stopped "in transit" prior to delivery at the appointed destination.

Under the facts stated, and disregarding any collateral issue between Alexander and the carrier as to the delivery at the intermediate point, were the goods still "in transit" after delivery to the buyer's agent? Explain.

c. On turning over the shipment to the Red Line Express, Alexander, the seller, had secured from the carrier a negotiable document of title (bill of lading) which Alexander had then indorsed in blank and sent to Davenport who in turn negotiated it to Perkins who took it as a bona fide holder. Before delivery could be made by the carrier to Davenport, Alexander learned that the buyer was insolvent. The seller thereupon sought to exercise the right of an unpaid seller to stop the goods in transit and demanded surrender of possession from the carrier. The carrier refused to surrender the goods unless the shipper first returned or had returned the negotiable instrument of title for cancellation. Thereafter Perkins presented the negotiable document of title to the carrier and demanded delivery of the goods.

   1. Was the carrier justified in refusing to surrender possession of the goods to Alexander, the shipper? Explain.
   2. Was Perkins entitled to delivery upon presentation of the negotiable document of title as against the shipper's demand for stoppage in transit? Explain.

Number 8

a. Keen, a CPA making an audit for his client Speedwell, finds in the accounts payable a recorded indebtedness of $2,500 based on his client's purchase of a light motor truck for business purposes. The truck was bought on credit for a total price of $3,000, Speedwell had made a payment of $500 down and the balance of $2,500 was payable three months after the down payment. The established *cash* price for the truck purchased is $2,400. In the state where the credit purchase took place the maximum contract rate of interest permitted by law is 10%. Keen considers that a question arises as to whether, upon the facts stated, the transaction is usurious.

   Do the facts as stated establish that the transaction is or is not usurious? Explain.

b. Distinguish by definition or otherwise between (1) legal rate of interest and (2) maximum contract (or lawful) rate of interest.

Number 9

a. Agents can be classified in terms of the number or scope of the matter entrusted to them to handle.
   1. Designate two classifications.
   2. Define each classification.
   3. Give an example of each.

b. Maxwell, a manufacturer, turned over certain merchandise to Paterson, a factor or commission merchant. Paterson undertook under the terms of a written agreement to sell the merchandise at stated prices on a factorage basis calling for Paterson to retain as his compensation any overage that he would receive above a $5,000 advance that he had made to Maxwell upon receipt of the goods. Paterson thereby acquired an irrevocable property interest in the subject matter of the agency. Before Paterson had sold any of the merchandise, two events occurred. First, Maxwell died. Second, two weeks after Maxwell's death all the merchandise turned over to Paterson was completely destroyed by fire without negligence on Paterson's part.

Was the irrevocable agency terminated by the occurrence of either event? Explain fully.

Number 10

S Co., which has several large apple orchards, entered into a written contract which provided that S was to sell to B by October 5, 1958, 1,000 bushels of apples, to be picked from a specific orchard owned by S. The price of $2.00 per bushel was to be paid upon delivery of the merchandise.

a. Before the apples were ripe enough to be picked a wind storm destroyed the entire orchard and S thus delivered no apples to B. Does B have a claim against S for damages? State the legal grounds which lead to your conclusion.
b. Assume that the orchard was only partially destroyed, and that S delivered 500 bushels of apples under the agreement. What rights has B? State the legal grounds upon which you base your conclusion.

EXAMINATION IN THEORY OF ACCOUNTS

May 15, 1959; 1:30 to 5:00 p.m.

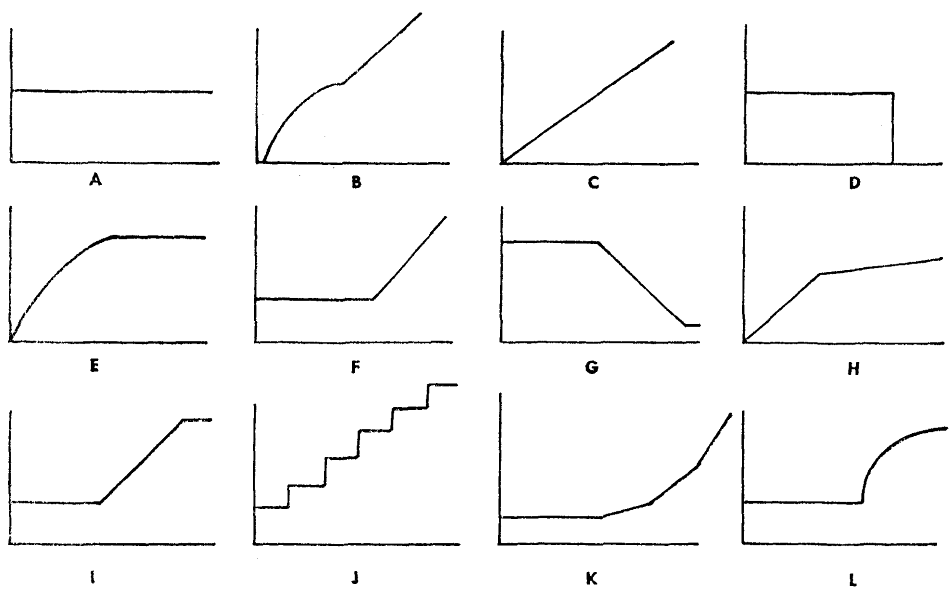
GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—15 to 20 minutes)

On a lined sheet of paper number the first ten lines from 1 through 10. Select the graph which matches the numbered factory cost or expense data and write the letter identifying the graph on the appropriate numbered line.

The vertical axes of the graphs represent *total* dollars of expense and the horizontal axes represent production. In each case the zero point is at the intersection of the two axes. The graphs may be used more than once.



1. Depreciation of equipment, where the amount of depreciation charged is computed by the machine hours method.

2. Electricity bill—a flat fixed charge, plus a variable cost after a certain number of kilowatt hours are used.

3. City water bill, which is computed as follows:

First 1,000,000 gallons or less	$1,000 flat fee
Next 10,000 gallons	.003 per gallon used
Next 10,000 gallons	.006 per gallon used
Next 10,000 gallons	.009 per gallon used
etc., etc., etc.	

4. Cost of lubricant for machines, where cost per unit decreases with each pound of lubricant used (for example, if one pound is used, the cost is $10.00; if two pounds are used, the cost is $19.98; if three pounds are used, the cost is $29.94; with a minimum cost per pound of $9.25).

5. Depreciation of equipment, where the amount is computed by the straight-line method. When the depreciation rate was established it was anticipated that the obsolescence factor would be greater than the wear and tear factor.

6. Rent on a factory building donated by the city, where the agreement calls for a fixed fee payment unless 200,000 man-hours are worked, in which case no rent need be paid.

7. Salaries of repairmen, where one repairman is needed for every 1,000 hours of machine hours or less (i.e., 0 to 1,000 hours requires one repairman, 1,001 to 2,000 hours requires two repairmen, etc.).

8. Federal unemployment compensation taxes for the year, where labor force is constant in number throughout year (average annual salary is $6,000 per worker).

9. Cost of raw material used.

10. Rent on a factory building donated by county, where agreement calls for rent of $100,000 less $1 for each direct labor hour worked in excess of 200,000 hours, but minimum rental payment of $20,000 must be paid.

Number 2 (Estimated time—15 to 20 minutes)

In the preparation of the consolidated balance sheet of a parent corporation and its subsidiaries a decision must be reached concerning the inclusion or exclusion of each of them as a member of the consolidated group. A common criterion is the percentage of voting stock owned by the parent company.

a. What is the significance of the percentage of voting stock ownership in justifying the inclusion of a subsidiray company in a consolidated statement?

b. List other criteria upon which the decision to consolidate or not may also rest.

Number 3 (Estimated time—20 to 30 minutes)

Your client, a manufacturer of heavy machinery, is contemplating replacing a considerable portion of the company's productive machinery. Much of the new machinery will be manufactured by the company. The client asks your opinion on the following methods of allocating factory overhead incurred during the construction of the new machinery:

(1) Charge no overhead to the new machinery.

(2) Charge new machinery with only that portion of overhead which is attributable to the new construction.

(3) Charge new machinery with overhead at the same rate as is used for finished goods.

a. What are the arguments in favor of each of these alternatives?

b. Which alternative would you recommend to your client? State the reasons for your choice.

GROUP II

(Estimated time—100 to 140 minutes)

(Answer only four questions in this group. If five are answered only the first four will be considered.)

Number 4

a. Goodwill which is permitted on a statement (other than a consolidated statement) is that which has been purchased. Describe briefly two explanations which have been used to justify the recording of goodwill in the balance sheet of a corporation or partnership.

b. Present two methods for estimating the value of goodwill in determining the amount which should properly be paid for it.

c. Discuss the propriety of the item "Goodwill" on the balance sheet in each of the following cases using the "cost" concept as a guide.
   (1) The excess of cost over book value of the net assets of firm A acquired by firm B.
   (2) Goodwill placed on the books of an existing partnership immediately preceding the admission of a new partner.
   (3) Goodwill arising from consolidation.

Number 5

Mr. Brown recently purchased some shares of stock in the Lalow Manufacturing Company, and is very much interested in the annual report to the stockholders which he has just received. He is confused by the use of the terms "expense" and "cost," found throughout the statements in this report, and has asked you to distinguish for him what accountants mean by the words "expense" and "cost," and how they can be used in so many places throughout the statements. The specific items which he questions are:

In the balance sheet:

a. Organization expense
b. A footnote, stating that Plant machinery and equipment includes "installation expenses" of $40,000

In the cost of goods manufactured and sold statement:

a. A classification "manufacturing expenses" with various items under this heading which include the term "expense"

You are to:

a. Distinguish between the terms "expense" and cost."

b. State how each of the items mentioned by Mr. Brown "fits" your definition. If you think any of these items are improperly called "expenses" indicate why and suggest more appropriate terminology.

Number 6

The cost of unemployment compensation taxes to an employer is sometimes reduced as a result of a "good" experience rating. A manufacturer negotiated with the federal government a contract which necessitated the construction of a specific plant and related facilities for the sole purpose of producing the goods called for in the contract. Since the goods were required to meet emergency needs of the government, it was possible that after the plant facilities were constructed, the employees hired, and work on the order begun, the contract would be cancelled. The ensuing termination of services of employees hired for this specific job would make the employer's experience rating worse, which in turn would increase the cost of his unemployment compensation taxes. This "possible" cost was recognized as a cost in negotiating the contract.

Describe in order of preference three alternate methods of recording in accounts and/or disclosing on the financial statements the "possible" cost during the course of operations of this emergency plant under the contract. State your reasons.

Number 7

You have a client engaged in a manufacturing business with relatively heavy fixed costs and large inventories of finished goods. These inventories constitute a very material item on the balance sheet. The company has a departmental cost accounting system that assigns all manufacturing costs to the product each period.

The controller of the company has informed you that the management is giving serious consideration to the adoption of direct costing as a method of accounting for plant operations and inventory valuation. The management wishes to have your opinion of the effect, if any, that such a change would have on:

(1) The year-end financial position.

(2) The net income for the year.

(3) The audit certificate on the year-end statements.

State your reply to the request and the reasons for your conclusions.

Number 8

Three theories of accounting equities are: (1) the proprietary theory, (2) the entity theory, and (3) the funds theory.

a. Describe briefly each of these theories.

b. State your reasons for emphasizing the application of one of these theories to each of the following:
   1. Single proprietorship
   2. Partnership
   3. Financial institutions (banks)
   4. Consolidated statements
   5. Estate accounting

Examination, November, 1959

EXAMINATION IN ACCOUNTING PRACTICE—PART I

November 4, 1959; 1:30 to 6:00 p.m.

(All problems are required)

Number 1 (Estimated time—30 to 45 minutes)

The Hale-Haworth-Nye Partnership was formed in 1950 with partner Hale contributing the major portion of the capital, and partners Haworth and Nye providing the knowledge and experience necessary for the operation of the business. The partnership agreement specifies that the accounting records shall be maintained on the accrual basis, and that the net income shall be distributed to the partners in the following manner:

1. Each partner shall receive five per cent interest on the balance in his capital account at the beginning of the year.

2. Partners Haworth and Nye shall each receive a commission of twenty per cent of an amount representing net income determined by the cash basis method of accounting after deducting the normal allowance for depreciation, and the interest on capital. For this purpose all merchandise purchased is to be treated as an expense.

3. The net income remaining after deducting the interest on capital and commissions due to Haworth and Nye, shall be distributed to the three partners equally except that the total portion of income distributed to partner Hale must not be less than fifty per cent of the net income determined by the accrual basis method of accounting.

During the year $150 of accounts receivable were considered uncollectible and charged off to the allowance for doubtful accounts, and $10 was collected on accounts which had been charged to the allowance for doubtful accounts in prior years.

There were no changes in the partners' capital accounts during the year.

Hale-Haworth-Nye Partnership

Balance Sheets

Assets	*December 31, 1957*		*December 31, 1958*	
Cash		$ 7,000		$ 11,120
Accounts receivable — customers	$ 5,000		$ 6,000	
Deduct—Allowance for doubtful accounts	100	4,900	120	5,880
Inventory		26,000		24,000
U. S. Government bonds—at cost		—		8,000
Fixed assets—at cost	120,000		120,000	
Deduct—Accumulated depreciation	42,500	77,500	46,300	73,700
Prepaid expenses		1,000		800
Total Assets		$116,400		$123,500

Liabilities and Capital				
Accounts payable—trade		$ 7,000		$ 4,000
Accrued wages		3,000		5,000
Accrued taxes		500		500
Deferred income		5,900		—
Net income, year 1958		—		14,000
Partners' capital:				
Hale	$ 80,000		$ 80,000	
Haworth	12,500		12,500	
Nye	7,500	100,000	7,500	100,000
Total Liabilities and Capital		$116,400		$123,500

Required:

a. A schedule supported by clearly detailed computations showing the adjustments necessary to convert the net income for the year 1958 from an accrual basis to a cash basis.

b. A statement supported by clearly detailed computations showing the distribution to the partners of net income for the year 1958.

Number 2 (Estimated time—20 to 35 minutes)

You have been engaged to review the records and prepare corrected financial statements for the Graber Corporation. The books of account are in agreement with the following balance sheet:

Graber Corporation

Balance Sheet

December 31, 1958

Assets

Cash	$ 5,000
Accounts receivable	10,000
Notes receivable	3,000
Inventory	25,000
	$43,000

Liabilities and Capital

Accounts payable	$ 2,000
Notes payable	4,000
Capital stock	10,000
Retained earnings	27,000
	$43,000

A review of the books of the corporation indicates that the following errors and omissions had not been corrected during the applicable years:

December 31	*Inventory Overvalued*	*Inventory Undervalued*	*Prepaid Expense*	*Prepaid Income*	*Accrued Expense*	*Accrued Income*
1955	$ —	$6,000	$900	$ —	$200	$ —
1956	7,000	—	700	400	75	125
1957	8,000	—	500	—	100	—
1958	—	9,000	600	300	50	150

The profits per the books are: 1956, $7,500; 1957, $6,500; and 1958, $5,500. No dividends were declared during these years and no adjustments were made to retained earnings.

Required:

Prepare a worksheet to develop the correct profits for the years 1956, 1957, and 1958 and the adjusted balance sheet accounts as of December 31, 1958. (Ignore possible income tax effects.)

Number 3 (Estimated time—35 to 50 minutes)

Following are the income and expense accounts shown on the books of A. Realty Corporation for the year ended December 31, 1958:

Sales of housing		$500,000
Rental income		60,000
Cost of construction of housing sold	$450,000	
Profit on trade of depreciable equipment		1,000
Loss on sale of depreciable equipment	2,000	
Oil royalties received		10,000
Bad debt expense	2,000	
Provision for depreciation of equipment	25,000	
Other expenses	30,000	
	509,000	571,000
		509,000
Net income before federal income taxes		$ 62,000

Additional information:

Depreciation provided in the books is by the straight-line method. For income tax purposes, the corporation has elected to use the sum-of-the-years' digits method for eligible assets and $20,000 additional depreciation is deductible in the income tax return. It is assumed that the difference in depreciation by the two methods is material and that use of the accelerated method will defer income tax for only a relatively few years. Other differences in depreciation for tax purposes are to be ignored.

The profit on trade of depreciable equipment is analyzed as follows:

Cost of equipment traded in—acquired January 1, 1950	$30,000
Provision for depreciation to date of trade	20,000
	10,000
Allowance received in trade for similar equipment	11,000
Profit on trade	$ 1,000

The loss on sale of depreciable equipment comprised:

Cost of equipment—acquired January 15, 1952	$10,000
Depreciation provided to date of sale	4,000
Balance of cost	6,000
Sales price	4,000
Loss—book and tax basis the same	$ 2,000

Oil royalty interests have no cost basis. Percentage depletion for income tax purposes is 27½%.

Bad debt expense on the books represents the provision for the year added to an allowance for bad debts. The corporation uses the charge-off method in its income tax returns. Changes in the allowance for bad debts during the year were:

Balance at January 1, 1958	$10,000
Provision charged to expense	2,000
Recoveries of accounts written off in prior years—tax benefit received from write-offs	3,000
	15,000
Bad accounts written off	2,000
Balance at December 31, 1958	$13,000

During the year the corporation exchanged real property, acquired in 1940 and previously used in its operations, for capital stock of B Company held by an individual who had owned the stock for 5 years. The cost of the property exchanged less depreciation was $25,000, also its tax basis. No gain on the exchange was recorded in the books, and the investment in capital stock is carried at $25,000, although the stock at the time of the exchange had a ready market value of $100,000.

Federal income tax rates applicable to the corporation's taxable income are 30% on the first $25,000 and 52% on the excess. The alternative tax rate applicable to net long-term capital gains is 25%.

Required:

a. Prepare a schedule showing the items comprising federal taxable net income for the year and compute the income tax liability to be shown on the return.
b. Compute the provision for federal income taxes to be made in the corporation's statement of income for the year.
c. Discuss briefly any differences between this provision and the liability shown on the income tax return, and describe the treatment of the provision in the income statement and the balance sheet.

Number 4 (Estimated time—45 to 60 minutes)

The Unstable Furniture Company commenced business operations on January 1, 1957. All sales are made on installment contracts and inventory records are on a periodic basis. Contract receivables are kept separate by years. At the end of each year adjustments for unrealized and realized gross profits are made through a Deferred Gross Profit on Installment Sales account. Defaulted contracts were recorded by debiting the Loss on Defaults account and crediting the appropriate contracts receivable account for the amount unpaid at the time of default. All repossessed merchandise and trade-ins should be recorded at realizable values. Presented below is information taken from the accounts of the Unstable Furniture Company.

Contracts receivable (unpaid balances):	*1957*	*1958*
1957 Accounts	$ 62,425	$ 3,175
1958 Accounts		101,375
Installment sales	138,675	220,925
Purchases	160,000	154,600
New merchandise inventory, December 31, at cost	60,154	73,042
Loss on defaults		5,000

Additional information:

In the process of your audit you find that the following items were not included in the inventory taken on December 31, 1958:

(1) Merchandise received as a trade-in on December 15, 1958, for which an allowance was given. The realizable value of the merchandise is $500 which was the allowance for the trade-in. No entry was made to record this merchandise on the books at the time it was received.

(2) Repossessed merchandise, originally sold in 1957, representing the only default and repossession by the company to date, had a realizable value of $2,000 at the time of repossession and at December 31, 1958. No entry has been made to record this repossessed merchandise.

Required:

a. Prepare the adjusting entry to record the trade-in merchandise.
b. Compute the gross profit percentages for 1957 and 1958.
c. Reconstruct the Deferred Gross Profit on Installment Sales account by years through December 31, 1958, showing in good form, all computations for the amounts included in the account.
d. Prepare the entry necessary to adjust the Loss on Defaults account.

Number 5 (Estimated time—50 to 80 minutes)

The Stanger and Theeler Company established a non-contributing profit-sharing trust for its employees, effective January 1, 1956. Contributions to the trust have been determined to be allowable as a deduction on the company tax return. The records of the trust have been kept by the company bookkeeper who has been able to compute prior years' distributions accurately. He hands you the following trial balance of the trust at December 31, 1958:

Stanger and Theeler Employee Profit-Sharing Trust

Trial Balance

December 31, 1958

Cash in bank	$1,505	
Savings and loan shares	1,000	
Government securities	2,000	
Stocks	1,095	
Loans to members	500	
Accrued interest receivable	85	
Liability to members		$6,000
Interest earned		260
Dividends		50
Payment on account to separated employee	115	
Brokers' fees	10	
	$6,310	$6,310

From employee records and records of the trust, you determine the following:

Name	Date Employed	1958 Salaries	Trust Account Balances December 31, 1957
John Jones	2/1/38	$20,000	$2,500
Mary Smith	12/10/53	5,000	500
Oscar Johnson	1/20/43	15,000	1,500
Wendell Davis (Quit 8/31/58)	8/10/52	5,900	500
James Saunders	6/2/50	10,000	1,000
Susan Jacobs	8/10/56	5,000	
Sam Dodd	10/20/57	5,000	
		$65,900	$6,000

The profit-sharing trust agreement provides:

1. The annual company contribution to the trust is to be computed on the basis of income as determined for tax purposes, but before deduction of the profit-sharing contribution. The contribution is to be made at the rate of 10% of the first $50,000 of such income and 15% of the excess over $50,000.

2. Company contributions and relinquishments (forfeitures) are to be distributed to members in the employ of the company at the close of each year, on the basis of service and salary points; 1 point for each full year of company service and 1 point for each $100 of earnings for the year.

3. Annual earnings of the trust are to be distributed to members having balances in their membership accounts at the beginning of the year in the ratio that each such beginning balance bears to the total beginning balances.

4. An employee must have two full years of service to be eligible for participation in the trust. Eligibility for new members is to be determined as of the end of each particular year.

5. A member leaving the employment of the company for any reason other than at the instigation of the employer for cause is entitled to receive a percentage of his trust balance based on the number of full years of service with the company, as set forth in the following table:

1 year	10%
2	20
3	30
4	40
5	50
6	60
7	70
8	80
9	90
10	100 (Employees do not participate in the company contribution for the year of separation.)

Income of the company for the year ended December 31, 1958 amounted to $60,666.67 before income taxes and deduction for its contribution to the plan.

Required:

a. Compute the profit-sharing contribution.

b. Compute:
   (1) The distribution of company contributions to members' accounts.
   (2) The allocation of trust income to members' accounts.
   (3) The severance settlement and forfeiture of Wendell Davis.

c. Prepare in worksheet form a statement of the changes in the individual member accounts during the year ended December 31, 1958. (Show January 1, 1958 balances, all changes, and December 31, 1958 balances.)

d. Prepare a worksheet for the profit-sharing trust that shows all adjustments in the trust accounts for the year and the financial position of the trust on December 31, 1958. (Number and explain each adjustment on the worksheet.)

EXAMINATION IN ACCOUNTING PRACTICE—PART II

November 5, 1959; 1:30 to 6:00 p.m.

GROUP I

(Solve all problems in this group)

Number 1 (Estimated time—40 to 60 minutes)

Ace Publishing Company is in the business of publishing and printing guide books and directories. The Board of Directors has engaged you to make a cost study to determine whether the company is economically justified in continuing to print, as well as publish, its books and directories. You obtain the following information from the company's cost accounting records for the preceding fiscal year:

	DEPARTMENTS			
	Publishing	*Printing*	*Shipping*	*Total*
Salaries & wages	$275,000	$150,000	$25,000	$ 450,000
Telephone & telegraph	12,000	3,700	300	16,000
Materials & supplies	50,000	250,000	10,000	310,000
Occupancy costs	75,000	80,000	10,000	165,000
General & administrative	40,000	30,000	4,000	74,000
Depreciation	5,000	40,000	5,000	50,000
	$457,000	$553,700	$54,300	$1,065,000

Additional data:

1. A review of personnel requirements indicates that, if printing is discontinued, the publishing department will need one additional clerk at $4,000 per year to handle correspondence with the printer. Two layout men and a proofreader will be required at an aggregate annual cost of $17,000; other personnel in the printing department can be released. One mailing clerk, at $3,000, will be retained; others in the shipping department can be released. Employees whose employment was being terminated would immediately receive, on the average, three months' termination pay. The termination pay would be amortized over a five-year period.

2. Long distance telephone and telegraph charges are identified and distributed to the responsible department. The remainder of the telephone bill, representing basic service at a cost of $4,000, was allocated in the ratio of 10 to publishing, 5 to printing and 1 to shipping. The discontinuance of printing is not expected to have a material effect on the basic service cost.

3. Shipping supplies consist of cartons, envelopes and stamps. It is estimated that the cost of envelopes and stamps for mailing material to an outside printer would be $5,000 per year.

4. If printing is discontinued, the company would retain its present building, but would sublet a portion of the space at an annual rental of $50,000. Taxes, insurance, heat, light and other occupancy costs would not be significantly affected.

5. One cost clerk would not be required ($5,000 per year) if printing is discontinued. Other general and administrative personnel would be retained.

6. Included in administrative expenses is interest expense on a 5% mortgage loan of $500,000.

7. Printing and shipping room machinery and equipment having a net book value of $300,000 can be sold without gain or loss. These funds in excess of termination pay would be invested in marketable securities earning 5%.

8. The company has received a proposal for a five-year contract from an outside printer, under which the volume of work done last year would be printed at a cost of $550,000 per year.

9. Assume continued volume and prices at last year's level.

Required:

Prepare a statement setting forth in comparative form the costs of operation of the printing and shipping departments under the present arrangement and under an arrangement in which inside printing is discontinued. Summarize the net saving or extra cost in case printing is discontinued.

Number 2 (Estimated time—60 to 90 minutes)

The manager of The Thomas Manufacturing Company has reviewed the annual financial statements for the year 1958 and is unable to determine from a reading of the balance sheet the reasons for the changes in working capital during the year. He asks you for assistance and presents the following balance sheets of The Thomas Manufacturing Company.

	Dec. 31, 1958	*Dec. 31, 1957*	*Increase (Decrease)*
Goodwill	—0—	$ 200,000	$(200,000)
Buildings	$ 810,000	560,000	250,000
Land	140,000	150,000	(10,000)
Machinery	330,000	200,000	130,000
Tools	40,000	70,000	(30,000)
Bond investment	18,000	15,000	3,000
Inventories	210,000	218,000	(8,000)
Accounts receivable	180,000	92,000	88,000
Notes receivable—trade	21,000	27,000	(6,000)
Cash in bank	—0—	8,000	(8,000)
Cash on hand	2,000	1,000	1,000
Unexpired insurance—machinery	1,200	1,400	(200)
Deferred bond discount	2,100	2,500	(400)
	$1,754,300	$1,544,900	$ 209,400

Capital Stock	$ 700,000	$ 400,000	$ 300,000
Bonds payable	150,000	100,000	50,000
Accounts payable	58,000	52,000	6,000
Bank overdraft	4,000	—0—	4,000
Notes payable—trade	9,000	10,000	(1,000)
Bank loans—short term	5,500	6,800	(1,300)
Accrued interest	10,000	6,000	4,000
Accrued taxes	5,000	3,000	2,000
Allowance for bad debts	4,500	2,300	2,200
Allowance for depreciation	271,200	181,000	90,200
Retained earnings	537,100	783,800	(246,700)
	$1,754,300	$1,544,900	$ 209,400

You are advised that the following transactions took place during the year:

1. A two per cent dividend was declared and paid, on the oustanding capital stock at the first of the year.

2. There were no purchases or sales of tools.

3. Stock was sold during the year at 90; the discount was charged to the Goodwill account.

4. Old machinery which cost $4,500 was scrapped and written off the books. Accrued depreciation on such equipment was $3,300.

5. The Income Statement for the year, 1958, was:

Sales (net)		$1,250,000
Operating charges:		
Material and supplies	$250,000	
Direct labor	210,000	
Manufacturing overhead	181,500	
Depreciation	123,500	
Selling expenses	245,000	
General expenses	230,000	
Interest expense (net)	7,500	
Total		1,247,500
Net profit to retained earnings		$ 2,500

(There were no unusual items in any of the above listed income and expense accounts.)

Required:

a. An application of funds statement, supported by a schedule of working capital changes.

b. A cash flow statement, supported by a schedule detailing the cash provided or applied by profits or losses from operation.

GROUP II

(Estimated time—80 to 120 minutes)

(Solve any two problems in this group. If three are solved, only the first two will be considered.)

Number 3

The Walsch Company manufactures a single product, a mechanical device known as "Klebo." The company maintains a process cost type of accounting system.

The manufacturing operation is as follows:

Material K, a metal, is stamped to form a part which is assembled with one of the purchased parts "X." The unit is then machined and cleaned, after which it is assembled with two units of part "Y" to form the finished device known as a "Klebo." Spray priming and enameling is the final operation.

Time and motion studies indicate that of the total time required for the manufacture of a unit the first operation required 25% of the labor cost, the first assembly an additional 25%, machining and cleaning 12.5%, the second assembly 25%, and painting 12.5%. Manufacturing expense is considered to follow the same pattern by operations as does labor.

The following data are presented to you as of October 31, 1959, the end of the first month of operation:

Material K purchased—100,000 lbs.	$25,000
Part X purchased—80,000 units	16,000
Part Y purchased—150,000 units	15,000
Primer and enamel used	1,072
Direct labor—cost	45,415
Manufacturing expenses	24,905

	Unit Quantity
Units finished and sent to finished goods warehouse	67,000
Units assembled but not painted	5,000
Units ready for the second assembly	3,000
Inventories at the end of the month:	
Finished units	7,500
Material K (lbs.)	5,800
Part X (units of part X)	5,000
Part Y (units of part Y)	6,000
Klebos in process (units)	8,000

Required:

a. A schedule of equivalent labor production.

b. A schedule of total and unit costs incurred in production for:
   - (1) Each kind of material
   - (2) Labor cost
   - (3) Manufacturing expense
   - (4) Total cost of production

c. A schedule of detailed material, labor and manufacturing costs assigned to the units left in process.

Number 4

Omega Brothers Company operates a department store with some departments leased to outsiders. The operation of leased departments is fully integrated with the operation of owned departments. However, the buying is done by outside owners of the departments, and the inventory is the property of the lessees. The rental for space occupied is a percentage of sales.

Inventories of certain owned departments—restaurant, work rooms, etc., named "cost departments"—are valued on the basis of cost, and have been reduced to the lower of cost or market. The inventories of the remaining owned departments are computed on the retail-inventory method. The inventories of the "retail departments" have been taken on the basis of selling prices appearing on the merchandise at the close of business at January 31, 1959; all of the required mark downs were made prior to taking the inventory and the inventory was priced accordingly.

The profit and loss trial balance for the year ended January 31, 1959, is as follows:

	Debit	*Credit*
Sales		$3,185,400
Returned sales	$ 250,000	
Inventory, February 1, 1958	354,000	
Purchases (net)	1,930,000	
Provision for inventory shrinkage	24,000	
Loading account—7%		124,181
Administrative expenses	198,000	
Occupancy expenses	260,000	
Publicity expenses	136,000	
Buying expenses	96,000	
Selling expenses	420,000	
Leased department income		35,000
Net loss		323,419
Total	$3,668,000	$3,668,000

Omega Brothers Company has consistently followed a policy, to which your firm agrees, of adding 7% to purchases for retail departments. The offsetting credit is recorded in the account "Loading account—7%." A Reserve for Loading account is adjusted at the end of the year to remove unrealized profit from inventory. The 7% loading is to be used in computing the cost-retail per cent.

Your investigation reveals that:

(1) Sales and returned sales accounts are composed as follows:

	Sales	*Returned Sales*
Sales price:		
Retail departments	$3,055,400	$244,400
Cost departments	61,000	1,600
Additional charges—Consumers' taxes:		
Retail departments	65,000	3,700
Cost departments	4,000	300
Total	$3,185,400	$250,000

(2) Sales of leased departments of $310,000 and returns of leased departments of $29,000 are excluded from sales and returned sales accounts.

(3) Inventory at February 1, 1958 is composed as follows:

Cost departments	$ 3,400
Retail departments (including loading of 7% on net cost)	350,600

(4) Aggregate selling prices of February 1, 1958 inventory amount to $590,000.

(5) Purchases consisted of the following:

Purchases, cost departments (net)	$ 31,800
Purchases, retail departments (net)	1,774,019
7% loading on net cost of purchases, retail	124,181

(6) Aggregate selling prices of net purchases for retail departments amount to $3,280,000.

(7) Inventories at January 31, 1959 were:

Cost departments, at lower of cost or market	$ 4,200
Retail departments, at selling prices	952,000

(8) Additional mark up on purchases of $40,000 was taken during the year.

(9) Mark downs amounted to $116,000 and mark down cancellations to $5,000 during the year.

(10) The Reserve for Loading account showed a balance of $22,936 at February 1, 1958, to reduce inventory to cost.

(11) The Reserve for Inventory Shrinkage account at January 31, 1959, shows a balance of $24,000 accumulated by monthly provisions based on a percentage of sales.

Required:

a. Prepare the necessary adjusting journal entries to record the closing inventory and adjust the reserve accounts on January 31, 1959. Support each entry with clearly detailed computations.

b. Prepare a profit and loss statement worksheet which will reflect any necessary changes from book balances to adjusted balances.

Number 5

The City of Linde, organized on January 1, 1944, has never kept accounts on a double entry system. During 1958 the city council employed you to install a system of accounts. You made a study and determined the values of assets and liabilities in order to inaugurate the proper system as of January 1, 1959, the beginning of the city's fiscal year, as follows:

1. City Taxes Receivable—1958 and prior years (including 10% considered uncollectible)	$ 21,900
2. Investment in Securities	
(a) Earmarked to Bond Retirement	136,680
(b) Donated by J. Stark on July 1, 1958, the net income from which to supplement Library operations. The cost of all the stock to Stark was $50,000. Appraised value on July 1	65,400

3. Cash	
(a) For general operations, including $3,000 in petty cash	18,000
(b) Earmarked to investments for bond retirement (represents interest earned over the actuarial estimate)	840
(c) Balance of cash donated by J. Stark, the net income from which to supplement Library operations	12,000
(d) Undistributed balance of cash received from J. Stark investments and apartment rents	3,000
4. Buildings	
(a) For general operations	235,000
(b) Apartment building donated by J. Stark on July 1, 1958. Net income to be used in the operation of the Library. Cost of completion to Stark, July 1, 1948, $96,000 (exclusive of cost of land) with estimated life of 50 years, no salvage. Appraisal value on July 1, 1958	90,000
5. Equipment	
(a) For general use	280,000
(b) Apartment furniture purchased with donated cash, October 1, 1958, estimated life 10 years, no salvage. Cost	36,000
6. Streets and curbs built by special assessment funds in prior years. (All collected.) The City contributed one-third of the cost	300,000
7. Land	
(a) For general use	60,000
(b) For apartment building site	10,000
8. Supplies	
(a) For general operation	1,800
(b) For apartment house operation, purchased by income cash	300
(c) Originally purchased for general operation were transferred to and used in Library operations; no settlement has been made	2,400
9. Vouchers Payable—for general operations	16,000
10. 3% 30-year bonds payable, due on December 31, 1976. (Issued for purchase of land, buildings and equipment)	400,000

Required:

List the funds or group titles that would be required for the City on the basis of the above information, leaving at least 15 lines between each title. Under each title make one summary journal entry that will record all of the required accounts and amounts in the appropriate fund.

EXAMINATION IN AUDITING

November 5, 1959; 8:30 a.m. to 12:00 p.m.

(All questions are required)

Number 1 (Estimated time—10 to 15 minutes)

The following covenants are extracted from the indenture of a bond issue. The indenture provides that failure to comply with its terms in any respect automatically advances the due date of the loan to the date of noncompliance (the regular date is 20 years hence). Give any audit steps or reporting requirements you feel should be taken or recognized in connection with each one of the following:

(1) "The debtor company shall endeavor to maintain a working capital ratio of 2 to 1 at all times, and, in any fiscal year following a failure to maintain said ratio, the company shall restrict compensation of officers to a total of $100,000. Officers for this purpose shall include Chairman of the Board of Directors, President, all vice presidents, Secretary, and Treasurer."

(2) "The debtor company shall keep all property which is security for this debt insured against loss by fire to the extent of 100% of its actual value. Policies of insurance comprising this protection shall be filed with the trustee."

(3) "The debtor company shall pay all taxes legally assessed against property which is security for this debt within the time provided by law for payment without penalty, and shall deposit receipted tax bills or equally acceptable evidence of payment of same with the trustee."

(4) "A sinking fund shall be deposited with the trustee by semiannual payments of $300,000, from which the trustee shall, in his discretion, purchase bonds of this issue."

Number 2 (Estimated time—10 to 15 minutes)

The following events occurred in different cases, but in each instance the event happened after the close of the fiscal year under audit, but before all representatives of the auditor had left the office of the client. State in each case what notice, if any, you would take in your report on the fiscal year; the closing date in each instance is December 31, 1958.

(1) Merchandise handled by the company had been traded in the open markets in which it procures its supplies at $1.40 on December 31, 1958. This price had prevailed for two weeks, following an official market report that predicted vastly enlarged supplies; however, no purchases were made at $1.40. The price throughout the preceding year had been about $2.00 which is the level experienced over several years. On January 18, 1959, the price returned to $2.00, following public disclosure of an error in the official calculations of the prior December, correction of which destroyed the expectations of excessive supplies. Inventory at December 31, 1958 was on a cost-or-market basis.

(2) On February 1, 1959, the board of directors adopted a resolution accepting the offer of an investment banker to guarantee the marketing of $100,000,000 of preferred stock.

(3) On January 22, 1959, one of the three major plants of the client burned

with a loss of $50,000,000 which was covered to the extent of $40,000,000 by insurance.

(4) The client in this case is an investment company of the open-end type. During the early part of 1959 a wholly new management came into control. By February 20, 1959 the new management had sold 90% of the investments carried at December 31, 1958 and had purchased others of a substantially more speculative character.

(5) This company has a wholly owned but not consolidated subsidiary producing oil in a foreign country. A serious rebellion began in that country on January 18, and continued beyond the completion of your audit work. The press in this country has carried extensive coverage of the progress of the fighting.

Number 3 (Estimated time—15 to 20 minutes)

a. An auditor obtains data from several sources in the course of making an audit. These data and other details are incorporated in the working papers. List six general classifications of the content of working papers which are usually prepared in connection with an annual audit, and give an example of each classification. In classifying the content consider the source of evidence and the auditor's activities.

b. Give a list of forms or types of working papers that you would expect to find in an ordinary annual audit.

Number 4 (Estimated time—15 to 25 minutes)

Autos and Trucks, Inc., organized three years ago, buys passenger automobiles and trucks which it leases for periods of 18 months to four years. All purchases are made after a lease agreement has been signed. No supply inventories of any kind are maintained.

You have been engaged to make the first audit of the company's affairs. At the time you accept the engagement there are in force 100 leases covering 124 passenger cars and 80 leases covering 210 trucks.

Present in outline form the procedures you would follow in verifying gross income from lease contracts.

Number 5 (Estimated time—15 to 25 minutes)

The Hertle Engineering Co. specializes in the development of new products. It carries on extensive research for this purpose, and it consistently charges the cost of research to current operations. In January, 1956 it began a research project called "Project Able," looking to the development of a new machine. Work continued on the project until January, 1959, at which time a patent was applied for on the machine, and the project was closed. Because of the specific nature of the company's objective in the project and its confidence that it would result in a patent, the research costs of "Project Able" were charged to a special account. The balance of this account was transferred to "patents" account at June 30, 1959, when a patent was granted.

Give an audit program for the patent acquired as a result of "Project Able," assuming that you are auditing this company for the first time at December 31, 1959.

Number 6 (Estimated time—15 to 25 minutes)

You have been instructed to make an examination of the financial statements of Price-Marcus Manufacturing Company. You are furnished the following condensed balance sheet:

Cash	$ 100,000	Notes payable	$ 200,000
Accounts receivable—trade	300,000	Accounts payable—vendors	200,000
Deposits, due from officers, etc.	100,000	Rent, taxes, etc., payable	300,000
Inventory	400,000	Long-term debt	500,000
Plant and equipment	1,000,000	Capital stock	1,000,000
Investments and advances—subsidiaries	400,000	Retained earnings	200,000
Prepaid expenses and other assets	100,000		$2,400,000
	$2,400,000		

Your assistant will be carrying out most of the work. State for his guidance what information he should request third parties to confirm directly to him.

Number 7 (Estimated time—20 to 25 minutes)

Internal control, in the broad sense, includes controls which may be characterized as either administrative or accounting.

a. What comprises and is generally included in (1) administrative controls and (2) accounting controls?

b. What bearing do these controls have on the work of the independent auditor?

Number 8 (Estimated time—20 to 30 minutes)

You are requested by a department store client to study the inventory shortage results as shown by the departmental retail inventory control book (generally referred to as "retail synopsis ledger"). After investigation you discover the following:

1. Merchandise was erroneously sold for $20.00 when it should have been sold for $23.00.

2. Certain salespeople recorded simply the net sales value for items sold to employees instead of showing gross sales price less employee's discount.

3. Some buyers were marking merchandise higher or lower than the original retail price indicated on the invoices without preparing price change reports.

4. There were other buyers who were putting through a "mark-up" on items which had been previously "marked down" for a special sale.

5. In the actual taking of the inventory you noticed that buyers distributed the inventory sheets, their salespeople counted and listed the items and the buyers collected the sheets and turned them into the controller's office the following day.

6. Items set aside in the department representing merchandise sold on "lay away" terms were listed on the inventory sheets by the salespeople.

Required:

a. Explain briefly the principle of the retail inventory method as it pertains only to retail inventory control.

b. Explain the application of this principle to each of the above situations, stating whether or not each of these would have any effect on the comparisons of book and physical inventory balances and, if so, in what way would such effect operate.

Number 9 (Estimated time—20 to 30 minutes)

The financial statements of the Modern Manufacturing Company for the fiscal year ended September 30, 1959 are presented below. The president of the company has requested you to make this year's examination and render a short-form audit report on the statements. The report would be addressed to the board of directors and no restrictions would be placed on the scope of your audit work.

During the course of the audit you learn that inventories of finished products and work in process are stated at material cost alone, without including either labor or manufacturing overhead; that this practice has been followed for both tax and financial accounting purposes since the inception of the company in 1946; and that the elements of costs in the inventories should have been as follows at the beginning and end of the fiscal period:

	Finished Goods		*Work in Process*	
	September 30,		*September 30,*	
	1959	*1958*	*1959*	*1958*
Materials	$ 88,000	$ 75,000	$ 34,000	$ 31,000
Labor	55,000	52,000	16,000	14,000
Overhead	28,000	24,000	17,000	16,000
	$171,000	$151,000	$ 67,000	$ 61,000

Except for the company's inventory methods, the statements are found to be acceptable in all respects.

Through an examination of the previous auditor's working papers, you have been able to satisfy yourself as to the correctness of the physical count and material cost of the opening inventory.

Modern Manufacturing Company

Balance Sheet

September 30, 1959

ASSETS		*LIABILITIES*	
CURRENT ASSETS		CURRENT LIABILITIES	
Cash	$ 12,000	Trade accounts payable	$ 29,000
Accounts receivable (net)	22,000	Salaries and wages	5,500
Inventories, at material cost (first-in, first-out) or market, whichever lower	146,000	Taxes, other than taxes on income	8,000
		Taxes on income	13,000
		Total current liabilities	55,500
Prepaid expenses	6,000	STOCKHOLDERS' EQUITY	
Total current assets	186,000	Common stock, par value $100 a share, authorized, issued and outstanding 2,000 shares	200,000
Property, plant, and equipment (net)	158,000	Retained earnings	88,500
	$344,000		$344,000

Modern Manufacturing Company

Statement of Income and Retained Earnings

Year Ended September 30, 1959

Net sales of manufactured product	$750,000
Cost of materials, including freight	300,000
Gross profit on sales	450,000
Operating expenses	385,000
Earnings from operations	65,000
Other deductions, less other income	22,000
Earnings before taxes on income	43,000
Taxes on income (federal $12,000, state $1,000)	13,000
Net earnings	30,000
Retained earnings—September 30, 1958	58,500
Retained earnings—September 30, 1959	$88,500

Required:

Prepare an audit report (auditor's certificate) addressed to the board of directors, such as is justified in the circumstances set forth above. Do not submit financial statements or notes to financial statements.

EXAMINATION IN COMMERCIAL LAW

November 6, 1959; 8:30 a.m. to 12:00 p.m.

(All questions are required)

Number 1 (Estimated time—20 to 30 minutes)

The individual questions are intended as inquiries on fundamental points of law. Avoid searching for a hidden meaning, as none is intended. Let your answer represent your best judgment in each instance, on the plain meaning of the words of the question. If there should be minority viewpoints on the issue of law involved, use the conclusion which you think would be most generally followed.

a. The principal assets of a newly formed corporation consisted of numerous subscriptions to capital stock. Because the subscriptions had been recorded on the books, requests for confirmation were sent directly to the individual subscribers. Some replies denied liability and gave responses indicated below. If the subscription receivable is nevertheless legally valid, place an "X" on the appropriate line in the YES column of the accompanying answer sheet. If the reason given is sufficient to legally void the subscription, place an "X" on the appropriate line in the NO column of the answer sheet.
The specific responses were:

1. The corporation is not completely organized. Although it is a *de facto* corporation, it is not a *de jure* corporation.
2. I have paid nothing on the subscription, so it is therefore void.
3. The corporation did not notify me that it had accepted my subscription.
4. I have received no stock certificates.
5. I did not subscribe to the stock, I merely signed an agreement to subscribe.
6. My subscription contract provides that it is void unless 10,000 shares are subscribed. At this time only 9,000 shares have been subscribed.
7. The corporation is conducting a manufacturing business. I was informed that its business was to be confined to buying and selling.
8. The corporation has not ratified my subscription during a directors' meeting.
9. The subscription was not in writing.
10. I hereby withdraw my subscription.

b. J, K and L were general partners conducting a large retail furniture store. J, on his own authority and without express permission of either of his partners K or L, entered into a number of transactions, ostensibly on behalf of the partnership. The claimants, having no notice of J's lack of actual authority have submitted claims against the firm. If a claim listed below could be enforced against the firm, place an "X" on the appropriate line in the YES column of the answer sheet. If the partnership is not liable, place an "X" on the appropriate line in the NO column.

11. A claim resulting from the decision of an arbitrator selected by J.
12. A note given to finance a carload of refrigerators purchased for the partnership.

13. A customer gave the firm a note for the purchase of some furniture. J endorsed it to a finance company on behalf of the firm. JKL is being charged as endorser on the note.
14. A monthly statement from a department store for three suits purchased by J personally, but charged on the firm's account at the store.
15. J signed a contract of sale for the store building, which is in the name of the partnership. The buyer is seeking specific performance.
16. Suit on a note which J endorsed as agent for the firm, for the accommodation of one of the firm's suppliers.
17. Suit for foreclosure of a mortgage signed by J as agent for the firm, in connection with the purchase of a building for a new suburban branch of the business.
18. Claim for the purchase price of new store fixtures.
19. Claim for commissions by a salesman hired by J.
20. A claim by a customer for damages which had been rejected by L. J subsequently compromised with the customer and agreed to pay the amount now claimed.
21. Customer seeks refund of amount paid to the firm, claiming that she had paid her account twice—once to the office manager and once to J, who had kept the money.
22. Premium on insurance policy covering the store building.
23. Claim for the wholesale price of ten automobiles. J had told the seller that the partnership was entering the automobile business.
24. Rental for the first month of a five-year lease of a warehouse for storage of the firm's excess inventory.
25. Amount to which J had confessed judgment against the partnership.

c. H Company is conducting a wholesale hardware business. There is an asset account in the general ledger entitled Claims Against Suppliers. In support thereof, various correspondence and other documents appear in the files relating to shipments which involve damaged goods, shortages, improper merchandise, etc. The files indicate, for a number of claims included in the account, the situations which are listed below.

Standard purchasing procedure for H Company provides for the following: order by catalogue number; shipment, F.O.B. factory; terms, 2/10, net/30; H Company's brand name to be placed on all merchandise. Unless stated to the contrary, assume that the standard procedures are followed in every respect; that neither H Company nor the supplier is at fault for any damage to the goods; and that both H Company and the supplier can prove any assertions that are made. If the claim represented by the particular fact situation is properly included in the asset account, place an "X" on the appropriate line in the YES column of the answer sheet. If the facts do not warrant inclusion of the claim as an asset, place an "X" on the appropriate line in the NO column of the answer sheet. Caution: base your decision solely upon the legal issues involved.

26. Standard procedures followed without change. H claims damages for scratch on top of table.

27. Terms for shipment F.O.B. destination. H claims that leg on chair was broken.
28. Terms of payment C.O.D. H claims nails are rusty.
29. Terms of order were C.I.F. Shipment actually was sent F.O.B. factory. H claims that dishes were broken.
30. Order provided for sale or return within ten days of delivery. On the tenth day, H Company wrote to supplier that the goods were not satisfactory and requested shipping instructions. The goods were returned immediately upon receiving the reply. H seeks refund of the price paid.
31. Supplier failed to print brand name on cartons of screws. H claims that some of the cartons were broken and torn.
32. Only 90% of an order was delivered. H claims that this was a special order for a particular customer and therefore is entitled to a discount in the amount of the lost profit on the 10% which was not delivered.
33. Delivery of the goods was five days later than specified in the order. H Company refused delivery and claims refund of the deposit paid.
34. Goods ordered on approval. Although merchandise was in accord with the description in the catalogue, H Company sent notice of rejection upon inspection. Claims refund of the deposit paid.
35. Bill of lading made out to the order of the supplier. H Company claims damage for large dent in side of refrigerator.

Number 2 (Estimated time—15 to 20 minutes)

a. Jones, one of the best salesmen of the Vogel Automobile Agency, was approached by his good friend Smith with news of a wonderful prospect. Since Jones had other appointments for the evening, he told Smith to sign up the prospect, gave him the forms and instructions to follow, and told him that the company would give the commission to him if he made the sale. Unfortunately, in order to close the deal, Smith gave such a large discount that Vogel, the owner, wishes to avoid the sale. Vogel feels he is justified, inasmuch as Jones had no authority to hire salesmen.
   (1) What is the general rule of agency law that is applicable in determining whether or not a sale has been made? Apply rule to facts.
   (2) Name three exceptions to the general rule.

b. Vogel hired Child, seventeen years of age, to sell automobiles. Child made a very good deal and Vogel wishes to hold the customer to his bargain. The customer claims that a minor cannot act as an agent and there is consequently no contract. Can Vogel enforce the sale? What is the rule of law that will determine whether or not a sale has been made? Apply rule to facts.

Number 3 (Estimated time—20 to 30 minutes)

a. A new factory building was recently completed and the final payment to the general contractor was made. A subcontractor filed a lien on the real property, indicating that the general contractor had not paid him. The owner contends that the lien is invalid—first, because he paid the general contractor for these services and it would thus be unfair to charge him again; and second, since the subcontractor made his deal with the general contractor alone, the subcontractor should look only to the general contractor for remuneration. Is this a valid lien against the property of the owner? State and apply the legal principles affecting the two contentions of the owner.

b. Kruse is the owner of a single large piece of construction equipment which he hopes to pledge as security for a loan from a bank. An invoice for current repairs costing $500 is received. Attached to it is a statement from the Repair Shop explaining that possession of the equipment will be retained by the shop until this invoice and all other repairs for the past eight months, aggregating $6,000, are paid in full.
   (1) How would the bank's security be affected were it to make the loan under the circumstances?
   (2) What are the rights of the Repair Shop in regard to possession of the equipment and application thereof to collection of the full amount owing to it?

Number 4 (Estimated time—20 to 30 minutes)

The XL Corporation, as of September 30, 1959, had in its possession the following instrument, written in longhand, in pencil:

> January 3, 1959, for value received, I owe J. D. Smith fourt
> dollars ($40.00), payable on demand. K. C. Jones.

On the reverse side, also written in pencil, is the following:

> Pay to the order of XL Corporation, J. D. Smith

The note had been received by XL Corporation, along with several checks and some cash in payment for goods sold to Smith during the month of August. Jones is financially responsible, but has refused to pay the note, claiming that he is not liable, since he had given it as a down payment on a washing machine which Smith had not delivered to him. Neither Jones nor the XL Corporation has been able to locate Smith.

a. Is the note enforceable against Jones? Explain.

b. List and explain each requirement of negotiability as it applies to the instrument involved.

c. Explain and apply to this problem each of the provisions necessary for the holder of an instrument to become a holder in due course.

Number 5 (Estimated time—20 to 30 minutes)

a. The Emerson Corporation has protection against loss through dishonest or criminal acts of employees under a blanket fidelity bond of the XYZ Surety Co., covering each specified employee to a total of $5,000. A shortage of $2,000 in the accounts of Smith, a bonded employee, was discovered. He admitted abstracting the funds, promised to take no more, and agreed to repay the money at the rate of $100 per month to be withheld from his earnings. He was therefore retained in the position and no report of the peculation nor of his retention was made to XYZ. Several months later, the same bond being in force, Smith abstracted another $1,000. Emerson thereupon reported both defaults to XYZ and filed a claim for $2,800 ($2,000 plus $1,000, less $200 withheld from Smith's earnings). XYZ accepted the first claim in the net amount of $1,800, but contends that failure to report the first loss originally and Smith's retention as an employee had released it from any liability for any losses incurred subsequently.

What amount can the Emerson Corporation expect to recover from XYZ Surety Co.? State the legal principles involved and indicate their application.

b. Included in the insurance polices of the Emerson Corporation is a performance bond relating to a contract for the construction of a new factory building.
   (1) What is the purpose of such a bond?
   (2) The building contractor has received several extensions of time for completion of the building. Numerous modifications in the original plans have been made. What legal principles would govern as to whether such extensions of time and plan modifications would bar recovery on the bond?

Number 6 (Estimated time—25 to 35 minutes)

a. Abbott, a CPA who was engaged in practice without any partners or associates, was retained by Abrams to audit his accounts and prepare a report including his professional opinion for submission to a prospective purchaser of Abrams' business. When the field work was about half completed Abbott became seriously ill, and was unable to complete the engagement. The prospective buyer lost interest and the sale of the business fell through.
   (1) Abrams sues Abbott for breach of his contract. Does he have a valid right of action for damages? Explain the legal principles involved.
   (2) Abbott sues Abrams for his fee for the work he was able to complete. Does he have a valid right of action? Explain the legal principles involved.

b. Larkin, sole proprietor of a small business, hired Mills by written agreement as his secretary for the period of one year at a salary of $6,000 to be paid in monthly installments. At the end of the third month Larkin died. The executor of Larkin's estate terminated Mills' employment and refused to pay the third month's installment on the contract. You are to prepare a balance sheet of the estate for the executor.
   (1) Mills has started suit for damages for breach of his employment contract. Would you set up any amount as a liability for this claim against the estate? Explain the legal principles involved.
   (2) Mills is also suing for the amount owed for services already performed under the contract. Would you set up any amount as a liability of the estate for the claim? Explain the legal principles involved.

Number 7 (Estimated time—25 to 35 minutes)

a. A disgruntled stockholder has informed you that there is "water" in the stock of the corporation.

(1) What is watered stock? Explain.

(2) Name three typical kinds of transactions which should be investigated to establish whether or not the stock was watered and explain how the transactions would create "water" in the stock.

b. You are further informed by the stockholder that there is an agreement restricting the free transfer of the corporation's stock.

(1) To what particular record(s) or sources would you refer in order to determine the terms of such an agreement which would be binding, as to reasonable restrictions, on a purchaser who gave full value for his stock without any actual knowledge of such restrictive agreement? Explain why you would refer to these particular record(s) or sources rather than to any others.

(2) Give two examples of restrictive provisions which have been generally accepted as reasonable.

(3) Give three examples of restrictive provisions which have been generally rejected as unreasonable.

EXAMINATION IN THEORY OF ACCOUNTS

November 6, 1959; 1:30 to 5:00 p.m.

GROUP I

(Answer all questions in this group)

Number 1 (Estimated time—10 to 15 minutes)

a. What is accounting for depreciation, and what is its objective?

b. Are the decreasing charges methods of depreciation consistent with this objective? Discuss fully.

Number 2 (Estimated time—15 to 25 minutes)

A portion of the combined statement of income and retained earnings of X Corporation for the current year appears below:

Net Operating Income		$ 37,220,000
Add: Other Income (net)		260,000
Net Income before income taxes		37,480,000
Provision for Income Taxes (before tax saving of $1,755,000 applicable to extraordinary loss on bond retirement charged to retained earnings)		19,482,700
Net Income		17,997,300
Add: Retained Earnings at beginning of year		99,162,700
Total		117,160,000
Deduct:		
Loss on retirement of bond issue prior to maturity (includes call premium, unamortized bond discount, and unamortized bond issue costs)	$ 3,375,000	
Less: Income Tax saving applicable to loss	1,755,000	
Net Loss	1,620,000	
Dividends Declared:		
On Common Stock (at $.50 per quarter)	13,500,000	
On Preferred Stock	300,000	15,420,000
Retained Earnings at end of year		$101,740,000

At December 31, X Corporation had outstanding 7,000,000 shares of $10 par common stock and 50,000 shares of 6% preferred.

On April 1 of the current year X Corporation had issued 1,000,000 shares of common stock for $32 per share to help finance the bond retirement.

Required:

a. Compute the earnings per share of common stock for the current year that should be reported to stockholders. Explain the reasons for computing it in your particular way.
b. Draft a paragraph suitable for inclusion in the annual report of the Corporation with reference to earnings per share. Earnings per share of common stock in the immediately previous year were $1.86.

Number 3 (Estimated time—20 to 30 minutes)

At December 31, 1958, the annual report of Petroleum Corporation contained the following item and accompanying explanation in a "Reserves" section immediately preceding the "Stockholders' equity" section:

Contingencies (Note 8)	$7,396,604

Note 8: This item, which has been provided for general undetermined contingencies, had the following changes in 1958:

Balance, December 31, 1957	$8,399,886
Charges to current income	466,400
	8,866,286
Restored to income	1,424,619
Payment for which the Reserve was established	45,063
Balance, December 31, 1958	$7,396,604

Required:

a. Give your opinion of the accounting practices which are indicated by this balance sheet item and the accompanying note.
b. Indicate the effect of these accounting practices upon the comparative financial statements.

Number 4 (Estimated time—25 to 35 minutes)

The total owners' equity (excess of assets over liabilities) is usually shown under a number of sub-captions on the balance sheet of a corporation.

Required:

a. List the major subdivisions of the "stockholders' equity" section of a corporate balance sheet and describe briefly the nature of the amounts that will appear in each section.
b. Explain fully the reasons for subdividing the amount of stockholders' equity, including legal, accounting and other considerations.
c. Describe four different kinds of transactions that will result in paid-in or permanent capital in excess of legal or stated capital.
d. Various accounting authorities have recommended that the terms "paid-in sur-

plus" and "earned surplus" not be used in published financial statements. Explain briefly the reason for this suggestion, and indicate acceptable substitutes for the terms.

Number 5 (Estimated time—25 to 35 minutes)

In negotiations for the sale of a going business an intangible factor called "Goodwill" is sometimes estimated by capitalizing average excess earnings, that is, by dividing average excess earnings by an assumed "earnings rate" factor.

Required:

a. Explain how the average excess earnings are determined.

b. What is the justification for the use of this method of estimating goodwill?

c. Under what circumstances is it appropriate to record goodwill in the accounts?

d. How, if at all, should goodwill, properly recorded on the books, be amortized in order to conform with generally accepted accounting principles?

Number 6 (Estimated time—25 to 35 minutes)

You have been requested by the Karol Company to assist them in determining the desirability of a proposed plan of "self-insurance" against the risk of loss by fire. (Disregard any income tax considerations.)

Required:

a. Explain what is meant by "self-insurance," and why it might be used.

b. List and explain the factors that affect the advisability of adopting a self-insurance plan.

c. Describe briefly two possible ways of accounting for such a plan, including for each way illustrative journal entries to:

(1) record the start of the plan,
(2) record a fire loss incurred.

d. Which of the two ways do you prefer? Explain fully.

GROUP II

(Estimated time—25 to 35 minutes)

(Answer one of the two questions in this group. If both are answered only the first will be considered.)

Number 7

It has been said that "Income determination is now based on a questionable concept which, for companies with a large investment in plant and equipment, distorts reported income unfavorably when prices are rising and favorably when prices are falling."

Required:

a. Explain fully the principal arguments used by those expressing the foregoing view.

b. What specific changes in presently accepted methods of determining income have been recommended by supporters of this view? Explain fully, including illustrations if appropriate.

c. What are the arguments used by those opposing the foregoing view?

Number 8

XZ Mining Company was recently formed by the issuance of 80,000 shares of $1 par value stock, sold on the open market for $5 per share. The proceeds were used to purchase undeveloped mineral properties. Because of other mineral discoveries in the general area of the company's properties, the price of the company's stock rose to bid $10 — ask $12, and with brisk trading remained at that level.

In order to develop these properties the company needed additional funds. It had been unable to place a $2,000,000 debenture issue even though an 8% interest rate was offered. Accordingly, in order to place the issue, it was necessary to sell units composed of a $1,000 debenture with 10 shares of common stock attached for $1,010. The debentures bear a 6% interest rate and are due at the end of 5 years. The total proceeds of the issue amounted to $2,020,000.

The units carried a requirement that the attached common stock could not be sold separately from the unit for at least thirteen months.

Required:

a. Compute the unit values to be assigned to,

   1. the debentures, and
   2. the common stock,

   taking into account both the dilution factor and the restriction on the common stock. For this purpose you may assume a 15% dilution factor and 10% for the restriction on common stock.

b. Give the journal entry to record the sale of the units, disregarding any commissions and other direct expenses of issuance.

c. Indicate the proper amounts and method of presentation of each of the items relative to this issue as they would appear in the financial statements at the end of the first year the issue is outstanding. Explain. (You may assume that the effective rate of interest on the issue is 8%.)

INDEX

Account balances
  Adjusting entries on books correcting 116
Accountants
  Independence 128
Accountant's liability
  Communicating results of work to client, discuss 17
  Skill and care in engagement, state 16
Accountant's office
  Purchase of practice, non-competition clause in 17
Accounting controls
  Bearing on work of independent auditor 163
  What comprises and is included in 163
Accounts receivable
  Assignment of, to finance company 76
  Audit steps to support amounts shown as 133
  Circularization of, types of accounts included in selection 133
  Initial examination 66
  Non-circularization of, unqualified opinion, short-form report 68
Accrual basis
  Cash required to pay amount due on tax liability 121
  Entries necessary to place books on 119
Administrative controls
  Bearing on work of independent auditor 163
  What comprises and is included in 163
Agency
  Auctioneer as agent, liability 72
  Designate and define two classifications 140
  Irrevocable, termination of 140
  Liability of principal for acts of agent 138
  Rule of, and exceptions, applicable in determining whether or not sale has been made 168
Agreements
  Oral, refusal to pay debt 72
  Written, constituted actual sale at time of making 16
  Written, when does title to goods pass 16
Alleged corporation
  De facto corporation, held to be 70
Apparent inconsistency
  Rule of conservatism which results in 104
Assets
  Overstatement of, audit steps to reveal 132
Assignment
  Define 19
Associations
  Dues 135
  Income from membership, audit procedures to verify 135
  Schedule of income, prepare 135
Auctioneer
  As agent 72
Audit program
  Contingent liabilities and commitments 66
  Patents 162
Audit working papers
  See Working papers
Auditing
  Cost of examination 93
  Initial examination 66
  Initial examination, presentation of items in balance sheet 69
  Initial examination, procedures applied to items in trial balance 69
  Standards and auditing procedures, distinguish 41
  Standards, name four generally accepted 41
Autos and trucks, inc.
  Leased equipment 162
Average excess earnings
  Determination of 174
Bailment
  Liability of carrier for loss of baggage 71
  Liability of parking lot for damage to automobile 71
Balance sheet
  Accounts, prepare worksheet to adjust 147
  Adjustments to, worksheet 119
  Consolidated 111
  Consolidated, inclusion of subsidiary company in, significance of percentage of voting stock 143
  Estate, prepare 170
  Items requiring adjustments 3
  Municipal general fund 114
  Municipal working capital fund 114
  Recording of goodwill in 144
  Summary, for book purposes, in reorganization 124
Bancroft corporation
  Audit 33

Bank confirmations
Value of, where officer of school district is also officer of bank 40
Bank reconciliation
Explain reasons for existing condition 12
Prepare schedule showing data 12
Bankruptcy
Effect of payment of debts 18
Statement of amounts available to each class of creditors 53
Statement of estimated deficiency to unsecured creditors 53
Banks
Income tax return 82
Bill of exchange
Define 19
Board of directors
Short-form audit report to 164
Bond
Define 19
Bond indenture 161
Boulevard homes, inc.
Audit 62
Branches
Columnar worksheet for company and 35
Reconciliation of current accounts of home office and 35
Budgets
Cash, prepare by months 54
Buildings
Depreciation of, and presentation on balance sheet 27
Business interruption insurance
See Insurance, Business interruption
Capital
Working, changes in, schedule 33, 155
Carriers
Common liability of, for injury to passengers 19
Liability of, for damage to goods for hire 19
Liability of, for loss of baggage 71
Cash
Balances, verification of, disclosure of irregularities 39
Petty, audit of, when amounts are immaterial 13
Settlement, joint venture 87
Cash receipts
Miscellaneous, examination of 14
Cash shortage
Municipal waterworks audit, unqualified opinion 96
Cease and desist order
Issued by Federal trade commission, define 45
Certificates of necessity
Accelerated amortization 22
Charities
Internal control to prevent misappropriation 40
City of Linde
Accounting system 159
Claims
Against suppliers 166
Liability of corporation for salesman's percentage of profits 99
Claxton machine company
Statement for loan, prepare 116
Closing date
Events occurring after 161
Inclusion of merchandise in client's inventory 12
Collateral
Right to, default on payment by third party 98
Collateral trust bond
Define 98
Combinations
Entries on books of corporation 74
Commercial law
Definitions and statements 136
Common carriers
See Carriers
Concessions
Operate on lease 76
Confirmations
Information requested of third parties 163
Conservatism
As used in accounting, define 104
Consistency
As used in accounting, define 104
Consolidations
And merger, distinguish between 44
Balance sheet, inclusion of subsidiary company in, significance of percentage of voting stock 143
Balance sheet, worksheet for 111
Changes in retained earnings, prepare schedule 5
Cost of stock of subsidiary, how handled on consolidated statements 24
Criteria for 143
Statements, analysis of items 105
Contract
Breach of 97
Breach of, in failure to complete audit 170
Breach of, in lapse of option 45
Breach of, liability for purchase price or damages 18
Breach of, ultra vires act 138
Breach of employment, liability of estate 170
Consideration for promise 45
Obligations of parties where goods are destroyed before delivery date 97, 141

Unwritten promise, unenforceable 45
Written promises to buy and sell products 97
Contractors
Balance sheet and income statement, prepare 3
Convertible bond
Define 98
Corporations
Succession to rights of another corporation 43
Cost
Items of 20
Cost accounting
Process costs 88
Cost study
Publishing and printing business 154
Costs
And expenses, distinguish between 144
Cotton manufacturers
Inventories, compute value of cotton in, for interim statements 34
Waste, compute pounds of loss due to, for interim statements 34
Creditor beneficiary 43
Damaged goods
Liability of common carrier 19
Damages
Liability of principal for acts of agent 138
Recovery of, for unfit goods purchased by description 19
Debenture bond
Define 98
Debentures
Journal entries, prepare to record conversion, amortization and interest 7
Journal entry to record sale of units 175
Unit values assigned to, compute 175
De factó corporation
Alleged corporation, held to be 70
Deferred income taxes
See Income tax
Del credere
Define 72
Department stores
Inventory, adjust journal entries 158
Profit and loss statement, worksheet reflecting changes from book to adjusted balances 158
Depreciation
Accounting for, define 172
Allowance, entries, and presentation on balance sheet 27
Change in method, adjust entries on clean surplus theory for accounts affected 88
Decreasing charges method 172
Increased rates of, for accounting and tax purposes, discuss merits 22
Straight-line method to sum-of-the years' digits method for tax purposes, changing from 131
Direct cost method
Change to, effect on audit certificate 145
Change to, effect on net income 145
Change to, effect on year-end financial statements 145
Dividends
Common stock, percentage available to recipients, in reorganization 124
Stock 48
Stockholders compel directors to pay, circumstances 70
Donee beneficiary 43
Drug store
Business interruption insurance 125
Dues
Income from, on cash basis as compared to accrual basis 135
Earned surplus
See Surplus
Earnings per share
Annual report, draft paragraph for inclusion in 172
Reported to stockholders, compute 172
Earth-moving equipment 7
Employment
Of minor, by company engaged in interstate commerce, statutes affecting 100
Enak manufacturing co., inc.
Statement of 51
Entity theory
Explain 145
Estate tax
Tax aspects of will 50
Estates
Balance sheet, prepare 170
Liability of, for breach of employment contract 170
Expenses
And costs, distinguish between 144
Express warranty
Define 43
Reliance on, failure to meet representation 98
Federal trade commission
Basic duty 45
Fidelity bonds
Collection on, in failure of company to report loss 169
Financial statements
See Statements
Finished goods
Entries to adjust, to cost for material 6
Fire insurance
See Insurance, Fire

Foreign exchange
Trial balance in U. S. dollars for Mexican subsidiary 80
Forgery
Of check, liability of parties involved 97
Frozen food
Inventory audit 93
Funds
Bond, T-accounts, balance sheet, prepare 55
Working capital, balance sheet 4
Working capital, journal entries to open 4
Funds theory
Explain 145
Goods in transit
After delivery to buyer's agent 139
Refusal to accept, by buyer and shipper 139
Right to stop, when buyer becomes insolvent 71
Stoppage 139
Goodwill
Amortization of 174
Average excess earnings, use of, in estimating 174
In accounts, recording of 174
In balance sheet, justify recording of 144
Valuation of, methods for estimating 144
Graphs
Match with numbered cost or expense data 142
Guaranty
Absolute (unconditional) 73
Hale-Haworth-Nye
Partnership 146
Happy home project
Cash collections 85
Hertle engineering company
Patents 162
Historical cost
Items included in, of machine purchased 104
Merchandise bought for resale 104
Holder in due course
Holder of negotiable instrument to become 169
Personal defense effective against 101
Holding companies and subsidiaries
Changes in retained earnings, prepare schedule 5
Consolidated statements, prepare working papers 80
Cost of stock of, how handled on consolidated statements 24
Trial balance in U. S. dollars for Mexican subsidiary 80
Worksheet, complete, making necessary eliminating and adjusting entries 5
Home building
Audit and prepare statements 62
Hospitals
Wording of opinion in special report on statements 94
Importing
Branch and home office accounts 35
Income
Determination of, in companies with large investment in plant and equipment 174
Net, accounting conventions 74
Periodic net, measurement of 48
Taxable, for tax purposes, how differs from income reported to stockholders 30
Income bond
Define 98
Income tax
See also Tax return
Adjusted gross income, deductions 1
Bad debt deduction 50
Balance due on, schedule showing 121
Calculation of, schedule showing 121
Capital gains and losses 50
Corporate, prepare worksheet showing computation 32
Deductions 1
Deferred, accounting theory involved, explain 22
Deferred, journal entries 22
Deferred, nature of, on financial statement, explain 22
Dividends 50
Liability, cash required to pay amount due on 121
Liability, compute 85
Liability, journal entries to adjust 85
Liability, prepare schedule showing 25
Proceeds from sale of stock 50
Questions in 108
Real estate transaction 50, 149
Reorganizations 124
Taxable business income from inadequate records 8
Incomplete records
Balance sheet accounts, prepare worksheet 8
Taxable business income from, prepare schedule 8
Independence
Accountants 128
Indorsement in blank
Define 70
Indorsements
Action against prior indorser 137
Liability of indorsers 46
Transfer of document of title, warranties 71

Initial examination
Accounts receivable 66
Trial balance items, audit procedures applied to 69
Trial balance items, in balance sheet 69
Installation expense
In balance sheet, explain 144
Installments
Amounts shown as realized income 47
Deferred gross profit 150
Gross profit percentages, compute 150
Journal entry to record repossession 47
Loss on defaults account, prepare entry to adjust 150
Purchase of equipment, accounting entries 22
Trade-in merchandise, prepare adjusting entry to record 150
Instruments
Presentment for payment 70
Insurance, Business interruption
Amount of loss subject to co-insurance penalty, compute 125
Amount of, required based on 80% co-insurance clause, compute 125
Amount to be received under policy, compute 125
Insurance, Fire
Examination of financial statements, auditor's responsibilities 67
Loss, schedule of expected recovery, working papers 67
Policy void in change in partnership 100
Insurance, Self
Define 174
Plan, accounting for 174
Plan, advisability of adopting 174
Insurance policies
Proceeds, collectible by creditors, explain 17
Proceeds, collectible by friend, explain 17
Interest
Usurious transactions 140
Internal control
Administrative or accounting controls in 163
Deficiencies and remedies 67
Major characteristics of satisfactory system 93
Sources of evidence 93
Inventory
Audit of, for processor of frozen food 93
Auditing procedure of, at date of acquisition and date of audit 13
Closing, in department stores, adjust journal entries 158
Cotton manufacturers 34
Inclusion of merchandise in client's, near closing date 12
Lower of cost or market, reported on comparative balance sheets 81
Merchandise, program of examination 41
Omission of observation procedures, effect on short-form report 41
Procedures to record properly items in the books for audit purposes 13
Quantities on hand at balance sheet date, audit procedures 133
Raw material, at cost or market, treatment in statements 47
Retail method 48
Retail method, principle of, application of, to various situations 163
Retail method, principle of, explain 163
Shortages 163
Unqualified opinion, frozen food processor 93
Unqualified opinion, when not present to observe 133
Valuation of, on products 113
Verification of, by governmental agency 41
Work-in-process, prepare statement showing details of material cost 6
Investment companies
Deferred income on real estate, compute 30
Income earned and gain or loss on real estate, compute 30
Investments in mortgages, determine gains and income from 30
Investments and securities
See also Stock
Sources and verification of information 130
Valuation at lower of cost or market 20
Invitation to trade
Offer to contract, distinguish from 16
Jekyll chemicals, inc.
Stock of 102
Johnson company 6
Joint ventures
See Ventures
Karol company
Self-insurance plan 174
Kiting
Detection of 128
Land
Presentation of, on balance sheet 27
Lease
Alterations in 73
Automobile, verification of gross income from contracts 162
Disclosure of, in financial statements 75, 94
Valuation of rental property in accounts 94
Warehouse, disclosure in financial statements 14

Lease bailment contract
  Disclosure in balance sheet 95
  Recording of, total installments paid under contracts, prepare worksheet 95
Leased departments 158
Leftgal, F. 3
Legal rate of interest
  Define 140
Liabilities
  Contingent, audit program 66
  Of corporation, claim of salesman as to percentage of profits, effect on accountant's report 99
  Understatement of, audit steps to reveal 132
Loans
  Examination of financial statements for 14
  Statement for, prepare 116
Machinery and equipment
  Allocation of factory overhead 143
  Auditing procedure at date of acquisition and date of audit 13
  Expenditures charged to operations or capitalized, factors to be considered 74
  Incidental costs charged to expense 47
  Procedures to record properly items in the books for audit purposes 13
  Replacement; Statement of estimated cost comparisons 80
  Sale of 8
Manufacturing accounts
  Transactions in, record 6
Manufacturing expense
  Explain 144
Mark-on
  Gross, and net sales, calculate 81
Marshaling assets
  Define 16
Materiality
  Unqualified opinion 128
Maximum contract
  Define 140
Medium city
  Funds 4
Membership associations
  See Associations
Mergers
  See Consolidations
Mining company
  Engineer's report, information necessary for loan 14
Modern manufacturing company
  Examination of financial statements, auditor's certificate 164
Mortgages
  Debt, liabilities of parties 99
  Investments in, determine gains and income 30
Motor trucks
  Working capital fund 4
Municipal
  Accounting system 159
  Accounts of water department, prepare worksheet and statements 37
  Balance sheets for funds 89, 114
  Bond fund T-accounts 55
  Funds or group titles 159
  Trial balance amounts by funds, classify 89
  Waterworks audit, cash shortage 96
  Working capital fund, prepare balance sheet and journal entries to open 4
  Working capital fund, statement of operations, balance sheet 114
Music stores
  Account balances, adjusting entries 116
Negotiable instruments
  Holder of, to become holder in due course, provisions necessary 169
  Negotiability of, under certain circumstances 169
  Notice of dishonor 137
Negotiation
  Define 19
New process
  Right of corporation in, discovered by employee 72
Non-competition clause
  Purchase of accounting practice 17
Notes receivable
  Difficulties in collecting 43
Notice of dishonor
  Actual wording of, requisite to 137
  In writing, explain 137
  Negotiable instrument 137
Offer
  Met with silence by offeree 16
  Revoked or terminated, three methods 16
Offer to contract
  Invitation to trade, distinguish from 16
Office building
  Selling price 56
Oil leases
  Auditing 40
  Basis of, for income tax purposes 40
  Capital and donated stock, balance sheet presentation 40
  Stock, reported or registered with SEC 40
Omega brothers company
  Department store 158
Opinion
  Non-circularization of accounts receivable 68
  Profit sharing pension trust 94
  Qualification of, lease on warehouse 14
  Qualification of, on inventories 14

Qualification of, on options granted to officers and employees 14
Rendered by independent certified public accountant, questions on 128
Unqualified, inventory of frozen food processor 93
Unqualified, on audit of municipal waterworks, cash shortage 96
Unqualified, procedures essential on statements when amounts are material 128
Wording of, special report on statements of hospital 94
Wording of, special report on statements of individual proprietorship 94
Options
Granted to officers and employees, disclosure in financial statements 14
Organization expense
In balance sheet, explain 144
Overhead
Allocation of, incurred during construction of machinery 143
Use of, in cost system 49
Pacific import company
Audit 35
Paid-in surplus
See Surplus
Parol-evidence rule
Exceptions to 16
Participating bond
Define 98
Partner by estoppel
Define 16
Partnership
Accrual to cash basis, adjustments to convert net income 146
Balance sheet, profit and loss general ledger accounts, worksheet 78
Billings to clients, compute 78
Capital accounts of, prepare adjusting entries of 25
Changes in partners' capital account, schedule 110
Debts incurred prior to admission as partner 70
Define 137
Dissolution, adjustment of accounts not governed by special agreement, state rules 16
Distributions to, and personal creditors, in dissolution, prepare worksheet 8
Distributions to, compute 146
Entries necessary to place books on accrual basis 119
Evidence of, receipt of share of profits 44, 70, 137
Financial position, worksheet 119
In dissolution final cash distribution to each partner 110
Journal entries to adjust accounts 119
Liability of, for acts of partner 166
Liability of, in misappropriation of client's funds 44
Partner's share of income credits and deductions 52
Profit allocation, worksheet 78
Results of operation of, on accrual basis, worksheet 119
Sale of assets, prepare computation for settlement of creditors' claims 8
Schedule of ordinary income 52
Statements of income, financial position, partners' equity, prepare 61
Voluntary and involuntary dissolution of, distinguish between 16
Where must books be kept in absence of agreement 16
Passengers
Liability of common carrier for injury to 19
Patents
Audit program 162
Right of corporation to new process discovered by employee 72
Payments
To outlawed account, constituting a new promise to pay 138
Payrolls
Internal control 42
Pensions
Cost of past service, debit as a 106
Costs, disclosure in financial statements 106
Costs, procedure for computing and accruing 106
Performance bond
Define 169
Recovery on 169
Personal defense
Define 19
Petty cash
See Cash
Phrases and statements
Agreement on by auditors 128
Pledged security
For loan 168
Plumbing contractor
Balance sheet and income statement 3
Power service department
Allocation of expenses to departments 76
Price level
Adjustments, confined to fixed assets and depreciation, pros and cons 23
Convert sales figures to, for income statement purposes 23
Price-Marcus manufacturing company
Examination of financial statements 163
Prices
Horizontal and vertical price-fixing, distinguish between 45

Printing
  Cost study 154
Products
  Breakeven point, compute 4
  Costs transferred from various processes, compute 113
  Income statement 113
  Inventory valuation 113
  Profit and loss statement 4
  Selling price per unit, compute 4
  Transfers of, from one department to another 75
Professional ethics
  Questions in 128
Professional men
  Accountant's responsibility to clients for care in engagements 16
  Legal duty in performing services, explain 16
Professional men's association of Middletown
  Income from membership 135
Profit
  Correct, prepare worksheet to develop 147
  Gross, on sales, prepare schedule 81
  Gross, changes in, prepare detailed analysis 26
Profit and loss statements
  See Statements
Profit or loss
  Joint venture worksheet analysis of net profit or loss 87
Profit sharing pension trust
  Valuation of assets 94
Profit sharing trust
  Allocation of trust income to, and changes in, members' accounts 151
  Contributions 151
  Financial position 151
  Severance settlement and forfeiture 151
Promise
  As used in contracts, define 16
Promissory note
  Alterations in 18
  Failure of consideration, personal or real defense 101
  Liability of indorser 101
  Negotiability of, effect of indorsements on 70
  Payable to non-existent person 70
Proprietary theory
  Explain 145
Proprietorships
  Balance sheet and income statement for 3
  Wording of opinion in special report on statements 94
Prosperous company
  Debentures 7
Publishing
  Cost study 154
Purchase discount
  Calculate 81
Purchase of a business
  Income and expense accounts, balance sheet accounts 42
  Review of accounting records 60
  Rules observed when purchasing entire assets of another corporation 44
Purchases
  Inventory at cost or market, treatment in statements 47
  On installments, accounting entries 22
Real defense
  Define 19
Real estate
  Audit of home builders accounts 62
  Deferred income on, compute 30
  Income earned and gain or loss on, compute 30
  Income tax 149
  Option lapse, damages for breach of contract 45
  Presentation of, on balance sheet 27
  Selling price of office building 56
Rent
  Cash collections, schedule 85
Rental property
  Valuation of building in the accounts; accounting entries 94
Reorganizations
  Carry-forward losses available as reduction of taxable income 124
  Net taxable income for federal income tax purposes 124
  Percentage of common stock dividend taxable to recipients 124
  Summary balance sheet for book purposes 124
Reports
  Engineer's, on mining company for loan 14
  Long-form, auditor's responsibility 68
  Long-form, materials included 68
  Short-form, change in sales cut-off date 39
  Short-form, non-circularization of accounts receivable 68
  Short-form, to board of directors 164
Research
  Costs 162
Reserves
  Effect of accounting practices on comparative financial statements 172
  In balance sheet, opinion of accounting practices 173
Restrictive indorsement
  Define 19

Retained earnings
  Statement, prepare 28
Return on investment
  Minimum rate of, to maintain present capitalized value per share 106
Revenue
  At time of sale 103
Salary
  Overtime 100
Sales
  Goods totally destroyed 19
  Payment in real estate and linens, Uniform sales act 71
  Revenue recognized at time of 103
Sales cut-off date
  Change in, effect on net income, disclosure in statements 39
  Change in, short-form report 39
Sampling
  See Testing and sampling
School districts
  Bank confirmations 40
Securities
  See Investments and securities
Self insurance
  See Insurance, Self
Service departments
  Allocation of expense to departments 76
Short-form report
  See Reports
Shortages
  Cash, in municipal waterworks audit, unqualified opinion 96
  Inventory 163
Skating rink
  Worksheets, journal entries 119
Social security
  Old age insurance benefits in year 72
Special indorsement
  Define 19, 70
Specific goods
  Define 43
Spoiled goods
  Entries for 104
Stanger and Theeler company
  Profit sharing trust 151
Statements
  Application of funds, supported by working capital changes 155
  Cash flow, detailing cash provided by profits or losses from operation 155
  Consolidated
    See Consolidations
  Disclosure, effect of change in sales cut-off date 39
  Disclosure in, of inventories 14
  Disclosure in, of lease on warehouse 14
  Disclosure in, of options granted to officers and employees 14
  Events occurring after closing date 161
  In comparative form, costs of operation of printing and shipping departments 154
  Income, items requiring adjustments 3
  Income, products 113
  Interim, inventories in 34
  Net change in working capital 51
  Profit and loss, for new product 4
  Profit and loss, reflecting changes from book to adjusted balances 158
  Profit and loss, supported by analysis of variations 64
  Source and application of funds 33
Statistical sampling
  See Testing and sampling
Statute of limitations
  Payment to outlawed account 138
Stock
  See also Investments and securities
  Capital, subscriptions to, confirmations 166
  Common, journal entry to record sale of units 175
  Common, unit values assigned to, compute 175
  Corporation's, free transfer of, restrictive agreement 170
  Cost of, of subsidiary, how handled on consolidated statements 24
  Preferred, cumulative and participating, explain 98
  Purchase and sale of own, accounting principles involved, journal entries 23
Stockholders
  Right of, to have public accountant examine corporate books 43
  When do liabilities terminate 43
Stockholders' equity
  Accounts, prepare schedule of recommended adjusting entries 28
  Balance sheet section, prepare 28
  Major subdivisions of, in balance sheet 173
  Subdividing amount of, explain reasons for 173
Subsidiaries
  See Holding companies and subsidiaries
Surety
  Collateral, rights of creditor 73
Surplus
  Earned, use of term in financial statements 173
  Paid-in, use of, in financial statements 173
Tax returns
  See also Income tax
  Bank 82

Net taxable income, balance payable or overpayment of tax, computations 58
Taxes
See Income taxes; Social security
Taxpayer manufacturing corporation
Corporate federal income tax, worksheet showing computation 32
Testing and sampling
Improvements in auditing resulting from 13
Weaknesses of traditional auditing procedures, state 13
Theft
Auditing procedures to uncover 134
Concealment of, internal control 134
Third party beneficiary contract 43
Thomas manufacturing company
Changes in working capital 155
Title
Refusal to pay purchase price on wheat destroyed 19
Tortious interference with a contract
Define 16
Trucks
Depreciation 95
Lease bailment contract, recording of, total installments paid, prepare worksheet 95
Ultra vires act
Breach of contract 138
Unemployment insurance taxes
Cost of, during operations of emergency plant, recording in accounts 145
Uniform partnership act
Provision that receipt of share of profits is evidence of partnership 137
Uniform sales act
Payment of goods in real estate and linens 71
Unpaid seller's lien
Define 43
Unstable furniture company
Installment sales 150
Variations
Analysis of, statement of profit and loss 64
From standard costs 64
Ventures
Joint, worksheet analysis of transactions 87
Voting
Cumulative, purpose and operation 98
Voting stock
Significance of percentage of, in justifying inclusion of subsidiary in consolidated statement 143
Walsch company 157
Warranty
Express, reliance on, failure to meet representation 98
Transfer of document of title for value by indorsement 71
Waste
Pounds of loss due to, compute for interim statements 34
Watered stock
Define 170
Waterworks
Accounts of, prepare worksheet and statements 37
Audit 96
Wholesale trade
Family partnership 61
Working papers
Forms or types of, found in annual audit 162
General classifications of content of, in connection with annual audit 162
Ownership 44
Transfer 45
Uses 12